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Is democracy a captive of capital? Sweden and the United States in comparative perspective

by

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Is Democracy a Captive of Capital ? Sweden and the United States in Comparative Perspective.
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ABSTRACT

By way of reviewing the 'business confidence' thesis and its impact on policy behaviour of a polyarchal state, this paper discusses two policy dimensions of the industrial landscape of Sweden and the United States : tax incentives to investment and pro-democratic labour laws. Faced with the same structural imperatives, these two countries are shown to have offered two very different 'mixes' of the said policies. Why the state in Sweden and the United States, both having predominantly capitalist economies, has not met the similar needs of capital in a uniform manner? An attempt to explain this variation leads us to put forth an institutionally-grounded and formally-reasoned argument that under a propitious institutional setting, state managers will have an incentive not only to induce physical capital, but also to entice full play of human capital through democratic reforms.

I. INTRODUCTION

One of the major challenges before the state in advanced capitalist democracies is to secure an adjustment between the needs of market and the goals of democracy. But the direction and the manner in which the state combines its 'market-stimulating' and 'democracy-promoting' policies are highly variable across the universe of western democracies. In this paper we shall investigate this variable capacity of the state to accommodate its competing commitments to growth and democracy by drawing a comparison between Sweden and United States — the commonly considered prototypes of the 'leading' and 'lagging' welfare states respectively. Expressed in a preliminary and telegraphic fashion, the claim that forms the central theme of this paper is that under a propitious combination of some specific institutions, the state can accomplish a 'policy mix' that maintains a good investment climate yet extends democracy. Its significance lies in the light it sheds upon the possibility of mitigating the allegedly formidable tension between the competing commitments of the state in a capitalist democracy: stimulating investment and enhancing democracy.

The manifold aspects of this tension between the two aspirations have been canvassed in the contemporary political economy literature. With a variety of accents, scholars have argued that in the process of boosting investment, public policies in a capitalist system create 'privileged position of business', which in turn sets limits upon the reach of democratic policies. But the analysis, for the most part, is pitched at a high level of abstraction, focusing on the concept of 'privilege' without carefully sifting empirical evidence on its range, magnitude or its variation in specific policy fields[1]. In this paper, we seek to push the discussion away from abstract, conceptual debates toward explaining actual, micro-level developments.

In so doing, we have three main objectives. The first is to flesh out the issue by casting a close look at the micro-sphere of firm and industry. More specifically, we study government efforts in two policy areas of industrial investment and industrial democracy in two advanced democracies of Sweden and the United States. Second, we determine the mutual correlation between these policy sets; this permits a test of the relative success of the state in the two countries to balance investment imperatives with democratic aspirations. Finally, we develop an institutionally-grounded and formally-reasoned understanding of why the state in these two systems, both having predominantly capitalist economies, has not met the similar 'needs' of capital in a uniform manner.

II. THE IMPERATIVE OF INVESTMENT INDUCEMENT AND ITS EFFECT ON STATE POLICY BEHAVIOUR

The business-confidence thesis, alternatively designated as the 'structural dependence of the state on capital' by Przeworski and Wallerstein (1988), is familiar by now. Reanimated in the works of Block (1977) and Lindblom (1977), the thesis embodies an interesting proposition about state behaviour in capitalist democracies[2]. Expressed simply, the central claim is that in a market-oriented economy, the state's reliance on capital and correlatively on investment activities of business constrains and distorts the range of its actions such that business preferences receive disproportionate policy attnetion; this again debilitates state's power to carry out a democratic policy agenda.

The entire society, so the argument goes, is structurally dependent on the actions of businessmen. Although public investments and spending significantly influence the growth of a capitalist economy, in order to adequately fulfil its revenue requirements, government policies need to boost private investment. Because, in the absence of sustained private investment, elected officials are likely to lose support, workers to lose their jobs and the society in general will suffer from declining growth. Thus a single stone of the growth imperative imprisons, if not kills, many birds, justifying rational acknowledgments of the 'needs' of capital by the whole society including of course the public officials. Many writers, including Weidenbaum (1979), G. Wilson (1981), J. Wilson (1981), Vogel (1989), have hotly disputed this argument. The general conclusions of their works suggest that there are significant variations in the relative policy success of business and that government officials become most responsive to business preference primarily during periods of economic downturns. While this focus on periodic variations in preferential policy treatments of business significantly refines the original question, it neglects an important piece of the theoretical puzzle.

Since good economic performance and correlatively good business climate are beneficial to all and since common gains will ensue from extending investment-cordial policy concessions to investors, why would such measures constitute expressions of limits on state actions? Indeed, there is little controversy among the studies of government-business relations that investment-stimulating policies are good for all. Following this non-zero sum logic of Pareto improvement, it would be in everybody's interest to entice business to act. Hence an examination of the pro-business activities of the state by itself will not suffice as a test for the proclaimed imprisonment of the state's autonomous efforts.

Instead, we need to ask whether and to what extent the pro-business incentive-policies of a polyarchal government lead to impairment of its democratic programmes. Put otherwise, the puzzle to unravel is whether to let the economic tree grow government will have to throttle the roots of democracy. Or can the polyarchal state accomplish a 'policy mix' that extends democracy as well as promotes investment? In short, the issue to investigate is how exactly business-assuring policies of public officials *co-vary* with their initiatives on the democratic front.

In principle, these are the two independent policy fronts of an advanced capitalist state and it is far from obvious why there will be a necessary trade-off between the two. In Lindblom's suggestions (1982), democratic projects will be voted out of the agenda due to their discouraging effects on business morale. But is investor-confidence in a market economy indeed eroded by democratic programmes? Such implicit democracy-disincentive linkage has to be made subject to close examination. Thus, an appropriate test of state policy behaviour and the alleged limitations of public decision-making will require us to explore a policy mix, ostensibly oriented to generating adequate investment while simultaneously pursuing democratic programmes.

III. TAX CLIMATE FOR INDUSTRIAL INVESTMENT AND LEGAL CLIMATE FOR INDUSTRIAL DEMOCRACY

As a measure of government's responsiveness to investment needs on the one hand and to democratic objectives on the other, we choose to examine two specific policy fields within the industrial landscape of Sweden and the United States, viz., tax incentives to industrial investment and 'industrial democracy' legislations. Taken together, these measures are expected to capture the tax climate for investment and the legal climate for workplace democracy. This in turn will likely delineate the professed contradiction between government's competing commitments to efficiency and democracy.

Why Tax Policy? Why Labour Law?

A few important reasons can be adduced to justify our focus on the industrial context and our choice of particular policies. In modern western societies, the industrial sphere continues to occupy a central place, both on grounds of efficiency and as a field for experiments in workplace democracy. Hence attention to the industrial world is appropirate; it will provide a window into the interplay of capitalist and polyarchal forces.

Looking at the tax incentives will likely offer an important indicator of the political influence of business. Taxation is of course one of the policy instruments used to stimulate private economic activities. But as Schumpeter (1943) noted long ago, taxes or the relief thereof are of fundamental importance to almost all business enterprises[3].

Similarly, industrial democracy as a method of introducing innovative changes in the world of work is receiving increasing attention from public officials across the western polyarchies[4]. An examination of those democratic innovations that are institutionalized through the vehicle of labour legislations in the United States and Sweden will likely reveal the magnitude of state responsiveness to democratic aspirations of workers in the two polyarchies[5].

Admittedly, the story of tax policies and that of reformist labour laws have been told before. But our emphasis is not on the individual policies as such, but on whether or not 'business-friendly' tax policies have been accompained by 'democracy-friendly' labour policies in the industrial sphere of Sweden and the United States.

A Time-Trend Analysis

Our chronicle of the relevant policies begins in 1935 and follows their chronological evolution in the two countries over a fifty-year block between 1935-1985. For both Sweden and the United States, mid-1930s marked some significant turning points in the state policy behaviour[6]. Not surprisingly, therefore, this period during which the state in both the systems appeared to have escaped the apparent constraint on its policy options is chosen as our natural starting point. We then follow the trajectory of the respective policies through the mid-1980s in order to discern the decisive policy pattern, if any, in the industrial world of Sweden and America.

Measuring Policy-supportiveness

Among the plethora of tax rules, we examine in precise terms those 'incentive mechanisms' that are contained in the federal Corporate Income Tax in the two polyarchies. In measuring accurately the expanse and depth of incentives contained in these tax codes, we follow the practice adopted in the standard economics literature, namely, the method of estimating incentives by calculating the Marginal Effective Tax Rate [METR], based upon the 'cost of capital' approach[7]. As we proceed to demonstrate below, generous incentives in both the U.S. and Swedish tax codes push the effective rate on industrial profit significantly below the statutory rate, indicating an over-all pro-investment stance of various tax regimes in these systems[8]. Within the broad field of industrial relations legislations, our attention is confined primarily to the Statutory Collective Labour Laws that work to promote or repress worker participation through independent trade unions[9]. To document year to year changes in these rules, we construct a labour law index purported to measure their supportiveness[10].

Finally, with the two sets of data (tax incentives and pro-democratic legislations) expressed as functions of time, we now come to a position to determine their mutual relation (Our assessment of state policy behaviour is articulated in terms of this correlation).

Scenario 1: If it is observed from the data that an increase in tax incentives over the time-frame considered has been accompained by a corresponding increase in legislated democratic rights of workers, then theoretically this would imply that the alleged constraints on democratizing policy attempts of the state imposed by the so-called 'investment imperative' are not so abiding.

Scenario 2: If, on the contrary, the extent of government-supported democratic initiatives records a retreat or remains stationary over the time interval, accompanied still by increasing tax incentives to business, then the existing thesis of the lack of state capacity vis-a-vis capital will be vindicated.

How do the experiences of Swedish and American industrial life square with these alternative scenarios? Do these two systems diverge in their capacity to combine the preferences of industrial managers with the demands of workers? The results of our findings and their interpretation are undertaken in the following section.

IV. POLITICAL ECONOMY OF THE INDUSTRIAL SPHERE

DEMOCRACY A CAPTIVE TO CAPITAL: THE CASE OF THE UNITED STATES

As a legislative history of the U.S. tax codes would reveal, a desire to promote growth with tax investment incentives has greatly influenced corporate tax policy in the United States. Particularly during the post-World War II period, the urgency to promote capital investment has been translated into an increasing use of investment incentives in the corporate tax code. For instance, depreciation allowances were accelerated in 1954, 1962, 1971 and 1981 (Auerbach 1983, Pechman 1985). The investment tax credit was introduced in 1962, briefly suspended in 1966, reinstated and liberalized in 1971 and increased in 1975. Again, in the two major tax reforms that have occurred in the early 1980s, investment incentives have played an unprecedented role[11]. All these have had the effect of reducing the marginal effective tax rate quite below the nominal rate. As Auerbach puts it succinctly, "There has been a general legislative movement toward reduced corporate taxation" (1983, p.455).

A quick look at Figure 1 clearly reveals that during the period 1952-1985[12] there has been a significant secular decline in marginal effective corporate tax rate, indicating an increasingly favourable economic environment for investment. Admittedly, this decline has not been smooth, with the major tax cuts followed by subsequent, albeit smaller increases; yet over-all the METR for the total non-residential sector fell by more than half from 61.2% in 1952 to 24.6% in 1982. This policy trend strongly suggests that business tax stimuli are far from intermittent or adhoc favours; on the contrary, the recurrence of incentive provisions in various tax bills reveals an unmistakable deference to business interests that emerges fundamental in patterning of tax policy outcomes.

What is more, business-oriented tax cuts have been only marginally affected by the relative strength of Democrats or Republicans in Congress or in the Administration (king 1983, Vogel 1989, Witte 1985). Despite the public perception of sharp differences between these two parties on tax issues, these divergences have been mostly rhetorical, concealing the underlying bi-partisan consensus on 'efficiency-driven' tax cuts. In the revealing words of King (1983 p.49), "Special tax stimulants to business investment have been proposed and passed by every single American President since

Eisenhower, a surprising record of bipartisanship". In short, a bi-partisan tax reduction has emerged as a dominant principle in the peacetime tax legislations of the United States.

On the front of industrial democracy, is the U.S. government pursuing its labour law policy with similar ardour? As we argue in the sequel, governmental efforts on this side of the ledger hardly match the overwhelming enthusiasm of public officials about encouraging industrial growth.

Our chronological survey of the evolving 'industrial relations' legislations in the United States suggests that laws have changed in four basic phases:

(1) The New Deal Era of Active Reform: The Wagner Act

(2) A Conservative Shift in the Legal Balance: The Taft-Hartley Act

(3) Partial Neutralization of Statutory Restrictions: The Warren Court

(4) Lean Years: Stunted Legislative Road to industrial democracy in the Reagan Era

Many believe that during the New Deal, a 'revolution' occurred in American legal thought in general and in labour law in particular. The Wagner Act (1935) is perhaps the most radical piece of legislation ever enacted by the U.S. Congress. In all the major areas of labour law, such as union recognition, the scope of collective bargaining, protection and immunities of workers engaged in concerted action, the Act made a vigorous attempt to restructure industrial democracy by legislative means.

In the year 1947 the enactment of the Taft-Hartley Act came as a severe blow to American labour; it shifted the legal pendulum against unions. It placed restrictions on many areas of workers' rights. The over-all restrictive intent of the Act was so obvious that Business Week, hardly a champion of the labour cause, declared in a 1948 issue that "The Taft-Hartley Act went too far... The Act conceivably could wreck the labor movement". The Landrum-Griffin Act in 1959 set out to further roll back union stregnth. The conservative accent of the post-New Deal model of federal labour policy practically arrested the nascent legal radicalism of the 1930s. In short, during the 1940s through 1950s the Congressional pendulum swung in a conservative direction.

Some neutralization of the restrictive impact of Taft-Hartley and Landrum-Griffin Amendments occured under the auspices of the Warren Court in the mid-60s and the early 70s. The court decisions taken during this period somewhat diluted the anti-union intent of extant legal provisions. But, this modestly progressive effect of the Warren Court eroded in the 1970s, culminating in the defeat of the mildly radical Labor Law Reform Bill in 1978. The fact that the combination of a Democratic President and a Democratic Congress could not pass the modest package contained in the Bill indicated what lay ahead for American labour.

Finally, in the early 80s, the conjunction of pro-management decisions of the Reagan Court and the Reagan Board [National Labor Relations Board], together with a massive employer resistance to unionization, has reverted the pendulum of law back to the excessively anti-union phase prior to the 1930s[13]. Indeed, the picture relayed in Figure 2 does not suggest a promising scenario of industrial democratization in the United States. Clearly, the policy success of U.S. workers through the passage of the Wagner Act stands in the American labour law history as a singular episode. Since then labour fortune in winning decision-making rights at the level of firm and industry has been going downhill. Whatever lawful democratic rights were accorded to workers under the orignial statutory scheme, the law that has emerged during the fifty years has been hardly helpful in promoting them. Especially over the past two decades legislative support to workers' rights has been in rapid retreat (Bruce 1989).

Most intriguingly, legal changes, or the lack thereof, have remained party-blind. To recall once again, "..mild technical reforms of ..labor legislation, of the most modest aspiration and limited potential effect [the Reform Bill of 1977], had been filibustered to death by a Democratic Senate under a Democratic Administration" (Hyde 1990, p.392). It seems as if the scepter of 'business confidence' has forced the policy makers to shy away from instituting democracy in the industrial sphere, irrespective of their partisan position. Consequently, American workers continue to experience a statutory climate generally unfavourable to their democractic aspirations, accompanied though by a highly congenial tax climate for industrial corporations. In short, the distinctive policy 'mix' that delineates the contours of the American industrial landscape turns democracy a captive of capital.

A Test of 'Possibilism'[14]: The Swedish Case

Is the lesson to draw from the preceding chronicle one of ineradicable incongurity between capitalist and polyarchal dynamics? The experience of the Swedish industrial world proves otherwise. It, instead, bears witness to a scenario where the state, though subject to the same structural constraints, adopts a policy path diverging significantly from the above in that it takes us away from the proclaimed failings of democracy while still satisfying the needs of capitalism.

Tracing corporate tax policy since the 1930s, we discover a business-friendly tax regime in Social Democratic Sweden. Contrary to the conventional expectations, in a country noted for its egalitarian social welfare policies, in a country with the highest overall tax pressure of all OECD countries, company tax policies over an extended period of time have sheltered a significant portion of industrial profits from an otherwise increasing tax bite; these policies have then effectively redirected them back into investment through an arsenal of incentives included in the tax code[15]. What has made this possible in a Social Democratic Sweden is a pragmatic attitude towards growth shared by all major politico-economic groups who all have a stake in an uninterrupted flow of industrial production in the open, extremely export-dependent Swedish economy.

Ever since Social Democrats came to power in the early 1930s, successive Social Democratic governments have introduced an impressive set of tax measures, carefully designed to spur investment. As early as in 1938, a tax legislation introduced a series of special exemptions, deferments and deductions. Some of these prominent deductions included: free depreciation system, Investment Reserve Funds [IF] system and special inventory valuation deductions. These pro-investment measures were continued with more or less intensity throughout most of the 40s and 50s.

During the mid-60s when the Swedish economy started showing the first signs of decline, expansion of industrial investment received renewed emphasis in policy making; depreciation rules were liberalized and the IF system was put to a more frequent use. In the midst of international recessions and the oil crisis in the 1970s, extending generous tax advantages to companies assumed a new proportion. "What's good for Volvo is good for Sweden", so said Finance Minister Gunnar Strang at a dinner for a business association in 1970. And the official tax reforms during this time clearly reflected the Minister's sentiment. Special temporary acceleration of depreciation was introduced. Most importantly, the IF system was converted from a periodic economic stabilization policy to a permanent investment stimulus. After having suffered two consecutive eletoral defeats[16], the Social Democrats came back to power in 1982 and immediately undertook vigorous attempts at regaining the confidence of business. In an effort to improve the domestic investment climate, "More emphasis was placed", two leading Swedish economists concur, "on efficiency and incentives and less on the goal of an equitable distribution of income" (Sodersten and Lindberg 1984, p.90).

Generous incentives contained in the Swedish corporate tax code pushes the effective tax rate on industrial profit significantly below the statutory rate. In order to compare the development of these two, it is instructive to examine the pattern displayed by the actual data[17].

Figure 3 summarizes the extant data (covering the years 1954-1978). The picture portrayed in this diagram indeed confirms that over the years increasingly handsome tax allowances have driven the effective rate considerably below the statutory rate and that this tendency has been strengthened over time[18]. Thus, the main long-term policy thrust has been one of spurring industrial investment through favourable tax treatment. As in the United States, the issue of investment has been a major determinant of tax policy outcomes. Indeed, in terms of investment taxation the Swedish case is consistent with the hypothesis of decisive business influence that Lindblom (1977) argues characterizes modern capitalism.

What is of particular importance is the endurance of such a policy arrangement in Sweden, a country noted for a long tenure and dominance of Social Democrats. Sweden has been governed for nearly sixty years by the Social Democrats, ostensibly engaged in building an egalitarian welfare state financed by painfully high tax rates. Hardly a place for industrial enterprise to flourish! And yet "... Sweden's socialist governments have preserved a system of corporate taxation that might have been drafted by a company treasurer... It would be hard to devise a tax system kinder to cash flow" (Fortune 1976, pp.154,155). Furthermore, Swedish labour, recognized internationally for its organizational and political success, has remained more or less quiescent about it.

Labour leadership's tolerance, if not zealous support, for generous corporate tax benefits has been motivated by a pragmatic understanding that the well-being of the working class depends upon the promotion of healthy corporations. In the export-dependent Swedish economy, the need to enhance the viability of private enterprises has remained abiding. Leadership's readiness to appreciate this necessity has been expressed in several official statements of the LO [the peak trade union organization]. But more importantly, workers' 'rational consent' has been induced also by a confidence that

Social Democratic control of power would ensure the channeling of the fruits of growth to the enhancement of workers' opportunities.

This becomes evident when we turn our attention to the policy successes of Swedish workers in the realm of power-sharing at the level of industry. In exchange for their conformity with pro-business tax policy, unions have been rewarded with favourable legislative programmes enhancing their 'voice' in industrial governance[19]. Indeed, by international standard Sweden's legislative efforts toward bringing democracy to the 'world of work' stand quite exceptional. Starting with the passage of the Act on the Right of Association and Negotiation in 1936, policy makers have embarked upon a steady pursuit of 'industrial democracy' legislations in the predominantly capitalist economy of Sweden. Since then, the Swedish industrial landscape has been shaped and modified by a series of statutes. Quite interestingly, while the pendulum of labour law in the United States has swung from 'reform' to 'restriction', the legal forces underlying the system here constitutes a 'progressive'[20] journey along the Swedish road to industrial democracy.

Put concretely, the legal climate has changed in two distinct phases: from a mild support to one of extensive repertoire of legal rights for workers. The first phase (1936-1970), alternatively dubbed as the epoch of Saltsjobaden[21], developed as a period of cooperation between the SAF (the Swedish Employers' Association) and the LO (Trade Union Association), when voluntarism between the private sector bargaining parties was only midly termpered by legislative means. Statutory rules covered a limited set of issues, leaving the sphere of managerial prerogatives largely intact.

The second phase, roughtly covering the period between 1970-1985, may be described as an era of accelerated legislative reform, launching a statutory attack on customary managerial prerogatives. In many ways, the legislative boom starting in the 1970s has underscored a breakthrough in workplace democracy (Adlercreutz 1990, Bouvin 1977, Edlund and Nystrom 1988, Martin 1977). With the passage of an impressive series of pro-labour laws between 1971 and 1976, policy makers have effected a substantial alteration in the 'structure of power' within Swedish enterprises (e.g. worker representation on company boards, enhanced power for safety stewards). Capping this statutory fiat, came the 1976 Co-Determination Act which remains the fulcrum of the existing labour law rules in Sweden. It has sharply curtailed many long-established managerial prerogatives, by bringing the whole range of managerial decisions within the scope of collective bargaining.

The legal indices capture the effects of these legal changes chronologically; the resultant findings are presented in Figure 4. The graph shows a continuous increase in favourableness of labour policy with a marked acceleration after 1975. With the American history of labour law in mind where the indices show considerable retrogressive changes, we may note that in Sweden the legal index rises steadily, in small ways and large, with no turnaround. Thus, the labour law reforms in the Swedish system have unquestionably stregnthened the position of employees and their organization; they amply demonstrate what can be achieved by legislation for deepening and widening workers' influence within the confines of a market economy[22].

Thus, the need for maintaining a congenial climate for industrial investment need not imprison the zone of labour policy making to the extent of putting a virtual stop to democratic initiatives[23]. By generalizing, in a polyarchal system the 'revenue imperative' and the 'democratic commitment' can be absorbed into a broad range of policies, before the two appear to be perilously incongruous.

V. THE INSTITUTIONAL COMPONENTS OF STATE POLICY BEHAVIOUR

The conclusions of the previous section simply raise the next set of questions. Why the state in the two countries, both having predominantly capitalist economies, has not met the similar 'needs' of capital in a uniform manner? If economic imperatives cannot fully explain policy outcomes, what are the political-institutional components that account for this variation?

An attempt to answer these questions leads us to argue that with some appropriate political and institutional infrastructures in place, the distribution of power among the key actors is such that it may create polyarchal forces (in our specific context, demands for democratic rights for workers) vigorous enough to achieve policy success; that is to say, policy makrers will not be uncritically deferential to all kinds of business demands to the exclusion of almost all reformist programmes. Conversely, in an unpropitious institutional setting, polyarchal control is unusually weak and business veto power is exceptionally strong; in such an institutional environment policy makers will overidulge business by providing an expansive definition of the 'required' business benefits and coincidentally will handcuff their own options.

The institutional framework surrounding U.S. industries is clearly not one which will encourage the mounting of pro-democratic reforms that empower workers. Put precisely, American workers are uniquely disadvantaged in articulating their democratic aspirations through electoral and party politics and much of this incapacity is owed to specific institutional barriers. First of all, low density and decentralized unionism debilitate the organizational strength of workers in the economic sphere. Second, the internationally unique characteristic of the U.S. political economy, namely, the absence of a pro-labour party significalty reduces workers' ability to receive attention from elected officials. Especially in a non-proportional electrol representation system, non-programmatic U.S. political parties have had little incentive to motivate workers. Workers' weakness in the industrial arena translates into their inability to wage reform struggle in the political arena. Organizationally weak and politically insignificant, workers pose no credible threat of 'exit'; by extension they are bereft of any meaningful 'voice' generating polyarchal pressures strong enough to elicit positive policy responses from officeholders[24].

The lack of these critical institutional resources, so charactersitic of the American industrial life, has shaped the state's policy behaviour to the detriment of workers' interests. Public officials have indeed accepted an expansive definition of 'what might hurt investor confidence'. Consequently, they have not only provided positive investment stimulants (tax incentives), but have simultaneously refrained from adopting the so-called policy disincentives (the allegedly investment-depressing labour law reforms) (Figure 5). Taken together, their policy orientations have shown a strong pattern of decisive business influence. Not surprisingly, state managers have refrained from making even timid efforts at tempering the market constraint for democratic purposes.

Within the Swedish industrial universe, on the other hand, a propitious combination of politico-institutional elements has caused to favourably alter the trade-off between capitalist and polyarchal forces. The picture revealed in Figure 6 is one of a concomitant expansion of investment-stimulating tax laws as well as pro-democratic labour laws over an extended period of time. Of course, the Social Democrats, the party that has ruled the country for an unusually long period of time, have been clearly attentive to business preference for a low tax burden. Especially in the 1970s, the period of low economic activity, maintaining business confidence received a spontaneous priority in Swedish tax policy agenda. But in tandem, policy makers were prodded by workers, with almost similar success, to institute democratic reforms at the workplace. Legal experiments in workplace democracy assumed an unprecedented proportion during the mid-1970s. Thus, market-conforming and market-modifying policies have gone hand in hand. This innovative policy package of the 1970s appears almost like a 'happy compromise' of the two structural imperatives (i.e. capitalist and polyarchal) facing the state.

In light of this, the alleged imprisoning effects of market constraint on the.reformist policies of the state do not appear so abiding. On the contrary, Swedish state managers seem quite capable of providing corporations the necessary encouragement, but at the same time not overindulging them through a virtual immunity from state-sponsorred democratic reforms. Two major institutional components seem crcial here: the organisational stregnth of labour and the distinctive party alignment resulting in Social Democratic parliamentary dominance. These two together account for politicians' willingness to enhance workers' voice in industrial decision-making[25]. In this institutional surrounding, public officials reject the notion that empowering workers' voice necessarily engenders investment disincentive. To the contrary, reformist programmes contained in labour laws are viewed as innovative means of inducing full cooperation of workers[26].

Stated generally, public officials feel the necessity not only to induce investment of physical capital but also to entice the full play of human capital. What follows in policy terms is then a better juxtaposition of political and economic forces in the system. It is the interplay of these two types of capital and its impact on the policy agenda of a polyarchal state that we turn to in the next section.

VI. BRINGING LABOUR BACK IN: THE STATE'S INCENTIVES TO INDUCE CAPITAL-PHYSICAL AS WELL AS HUMAN

In this section our task is to reintegrate the empirical insights, gleaned from the country-specific analyses, into extant theoretical currents. In so doing, we offer a formalized argument which, we believe, will allow us to go beyond the 'local' problem of the industrial world and establish claims about the 'global' question on the relationship between capitalism and democracy. Here, taking the cue from the human capital approach, we put forth an argument that the state in an advanced democracy may have incentives to respond both to interests of industrial managers and democratic demands of workers, when the latter hold, both organizationally and politically, a key power position comparable to one that accrues to businessmen.

As extensively documented in the extant political economy literature, the power of capital ensues from the critical element called 'capital mobility', that is to say, the capacity of owners of capital to withdraw their assets from productive use. By threatening market defection, businessmen can secure control of policy agenda. To use Hirschman's cogent formulations, 'exit' capacity of capital engenders disproportionate 'voice' of business in the decision-making process. Conversely, labour, though an important actor in the production process, posses neither. For example, in Lindblom's model (1977), mobility is too costly for labour. And this lack of mobility has the effect of stultifying their voice. But like capital, the contribution of labour constitutes a crucial input into the national output. As Lindblom clearly reminds us (1977 p.114), "If they do not work, the whole productive system halts".

Despite their essential services, however, workers do not enjoy any speical position in a capitalist economy. Because, unlike businessmen, they do not have any choice in determining their level of performance. Labour cannot use the 'threat of exit' option to put pressure on politicians to defer to their preferred policy position. Taking the lead from the increasingly popular human capital approach, we however argue that this total incapacity of labour to withdraw their resources from the market is a very restrictive assumption in Lindblom's analysis. It is this extraneous constraint that imposes substantial limits on the range of government's policy choices.

The Human Capital Approach

Contribution on the part of workers into the productive process is considered a critical investment variable in the burgeoning literature on the theory of human capital. Proponents of this thesis treat human resources as a form of capital; like that of physical capital this too is a 'produced means of production'. Is the investment of human capital, like that of physical capital, the exclusive prerogative of business? Does labour-wage exchange fully ensure the desired performance level of workers hired? Our position is that hiring of labour by business does not automatically elicit the former's full performance. Rather, the embodiment of human capital in workers, their continued control over the service supplied creates an allied possibility of the intentional withholding of the same by labour[27].

Labour being 'mobile' in this special sense, a polyarchal government needs to consider ways of inducing the required level of human capital investment, which is no longer constant as Lindblom suggests, but a critical variable in determining economic growth[28]. Democratization of the workplace may be one of the appropriate policy measures to ensure full play of human capital. Indeed, the underlying rationale behind contemporary forms of worker participation in almost all the modern polyarchies is that by providing employees with a greater voice in their immediate work environment, a democratic surrounding will likely minimize workers' propensity to reduce work performance.

Thus, the incentive structure that shapes the perception and policy behaviour of state managers in modern democracies need not get exhausted by enticing business alone; giving policy preference to the owners of human capital may also constitute an important motivation. What results from such a 'mix' of incentives, then, is a better policy package, inducing investment as well as instituting democracy. By generalizing, there exists a genuine possibility for positively altering the trade-off between capitalism and democracy.

A Brief Sketch of a Formalized Argument

Let us imagine a policy plane, spanned by the variables t_i which is taken to be the rate of tax incentive to corporations given by the government and D which is a measure of government's commitment to workplace democracy. The government chooses t_i and D to satisfy its dual commitment to growth and democracy.

Given the parameters t_i and D fixed by government, capital and labour, both possessing a potent threat of withdrawal, seek to maximaize their own utility by choosing investment of physical capital K and human capital L respectively. To define the utility functions of all the three actors we proceed as follows:

The total national product is defined to be a function of K,L denoted as:

$$f(K, L) \qquad (1)$$

Let us assume that out of this amount a fraction $t_i f(.)$ goes to the capitalist[29]. A fraction α of this amount is given to workers as wage by the capitalist, thus ensuring a profit P given by:

$$P = t_i\, f(.)\,(1 - \alpha) \qquad (2)$$

Now the gross revenue collected by the government is $(1 - t_I) f(.)$. A fraction β of this amount is given by the government to workers as transfer payments. Thus workers collect as total share of GNP,

$$W = \alpha t_I f(.) + \beta (1 - t_I) f(.) \qquad (3)$$

This leaves a net revenue to government:

$$G = (1 - \beta)(1 - t_I) f(.) \qquad (4)$$

Obviously, $P + W + G = f(.)$

We now make an additional assumption that, we believe, extends the existing models[30]: capital and labour are not only interested in the share of national product, but also in the distribution of influence in the world of work. Put otherwise, both parties are interested in having a 'voice' in the industry's policy-making process. Their utility is, therefore, a function of both monetary share and share of power. Thus the departure from extant formulations consists in attributing a dependence of the welfare functions of capital and labour on the new variables V_C and V_L, which measure their respective voice in industrial life.

Furthermore, these variables are taken to depend on the variables K, L, D introduced earlier, for the following reasons. The voice of each surely depends upon government's policy regarding industrial democracy as measured by variable D; but as mentioned before, voice is also a function of respective exit potential of capital and labour, as indicated through their control over investment of physical (K) and human (L) capital. Thus,

$$V_C = V_C(K, D), \quad V_L = V_L(L, D)$$

Now the utility functions of capital U_C and labour U_L can be expressed in the following forms:

$$U_C = U_C(P(K,L,t_I), V_C(K,D)) \qquad (5)$$

$$U_L = U_L(W(K,L,t_I), V_L(L,D)) \qquad (6)$$

Notice that the solution to the maximization of the utility function of capitalists <u>does not necessarily maximize profit.</u> For workers again the solution to the maximization of utility <u>is not necessarily wage maximizing.</u>

Given these assumptions, we need to show that a government is not constrained to choose t_I and D in a manner that leads to a trade-off between the two. Put otherwise, the optimum policy selection D* need not be a decreasing function of the optimal tax incentive t_I^* given to capital[31]. But this relationship, this 'rivalry' between growth and democracy, may result only when some added constraint is enforced, as we claim is implicit in the mainstream research[32].

A Formal Rendition of the Mainstream thesis

To mention once again, implicit in the extant research on policy behaviour of a polyarchal state is the idea that government has to entice business to invest with an array of positive incentives; but it has also to roll back investment-eroding programmes. In the present context, the relationship between positive incentives and potential disincentives, i.e., between optimal tax incentive policy t_I^* and optimal democratic programme D^* can be expressed as:

$$\frac{dD^*}{dt_I^*} < 0 \qquad (7)$$

To obtain this dependence we assume in accord with Lindblom and others:

$$\frac{\partial K^*}{\partial t_I^*} > 0 \qquad (8)$$

$$\frac{\partial K^*}{\partial D} < 0 \qquad (9)$$

We then make two other assumptions about workers in a capitalist polyarchy:

$$\frac{\partial L^*}{\partial D} > 0 \qquad (10)\text{[33]}$$

$$\frac{\partial L^*}{\partial t_I} > 0 \qquad (11)\text{[34]}$$

Finally, we come to a crucial assumption, implicit in Lindblom's argument, about the invariability of optimal labour performance L^* with respect to government policies.

Thus, $L^*(t_i,D)$=constant, which implies the constraint,

$$dL^* = 0 \qquad (12)$$

Since, in line with the imposed constraint, the net change in labour response is vanishingly small, we have:

$$\frac{\partial L^*}{\partial t_i} \cdot dt_i + \frac{\partial L}{\partial D} \cdot dD = 0 \qquad (13)$$

which implies,

$$\frac{dD}{dt_i} = -\left[\frac{\partial L^* / \partial t_i}{\partial L^* / \partial D}\right] \qquad (14)$$

As per assumptions (10) and (11), we, therefore, have for all t_i and D,

$$\frac{dD}{dt_i} < 0 \qquad (15)$$

Thus, it is the inclusion of the premise of the total lack of 'labour flight' into the model that locks state policy commitments in a manner such that business inducement automatically throttles democracy. But it is only in a very restrictive setting, absent all major institutional shields, that we can envision a scenario of advanced democracies where the state is required to suppress its democratic initiatives and succumb to the omnipresent 'needs' of capital. For the market to become an effective 'prison', we had to enchain our analysis with a stringently restrictive assumption the universality of which across advanced polyarchies is highly arguable.

VII. CONCLUSIONS

In this paper we have attempted to develop an institutionally-grounded, empirically-delineated and formally-reasoned understanding of the policy behaviour of a polyarchal state, operating under dual imperatives of market and democracy. We have seen how two different western democratic governments demonstrate common patterns regarding business taxation and investment incentives. We have illustrated, through the Swedish experience, how corporate tax policies under governments controlled by left wing parties are no less sensitive to their impact on capital investment than such policies under other types of government.

On the pro-democracy policy front, however, the perception of state officials about the alleged democracy-disincentive linkage has diverged significantly in the two countries studied and correlaively has led to their varying policy success in initiating workplace democracy. To the extent public officials in the United States have believed reformist labour laws to be a potential source of low investment, they have made policies that are the least invasive of managerial autonomy within the firm. Their Swedish counterparts, however, have rejected the notion that democratic reforms will engender investment disincentives. What is more, policy makers have been motivated to introduce innovative participatory schemes because of a growing perception among them about the instrumental value of democracy in enticing the full play of human capital.

The perception of state managers about the adverse policy effects on investment and their resultant policy behaviour are rooted, we have claimed, in the underlying power structure in the industrial world and in the larger political arena. More concretely, organzation and political strength of workers, the countervailing power of employers and patterns of party control of government are important influences on state policy choices. Stated otherwise, the state's policy response is not only influenced by economic imperatives but depends largely on the character of institutional-political regimes conditioning market and polyarchal forces. In line with the growing scholarly consensus, we must, therefore, conclude that political structures and distribution of power resources are important in enabling the state to alleviate the structural constraint of dependence and that democracy need not be an irretrievable captive of capital.

NOTES

1 For notable exceptions, see Jacobs (1985), Quinn (1985,1991) and Vogel (1984).

2 The origin of this reincarnated argument about the mobility of 'capital stock' for the best available 'business climate' and its imprisoning effects on the state's policy choices goes back to Adam Smith who wrote in 1776, "The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inqusition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he had left. Stock cultivates land; stock employs labour. A tax which tended to drive away stock from any particular country would so far tend to dry up every source of revenue, both to the sovereign and to the society...' (The Wealth of Nations), as quoted in Hirschman (1978).

3 The overall state of business confidence is integrally linked to the congeniality of the tax climate in a given country, because of the impact of the tax system on the process of capital formation. Especially, in the recent years there has been a growing interest in the potential of taxation as a device for investment stimulation.

4 "Industrial Democracy" is used here in a broad sense to include all state-sponsored or legally-supported programmes and structures through which employees have a voice in the decisions of an enterprise from negotiations of national agreement to consultation of work groups on the shop floor.

5 Here a mention may be made of the recent management-initiated participatory schemes, variously labeled as quality circles, quality-of-worklife, labour-management cooperation etc. However, employer-sponsored worker participation is sometimes viewed with skepticism. For example, in the United States recent years have witnessed both a movement toward employer-arranged participatory schemes and an intensified anti-union managerial posture. Many labour organizations view the employer-supported plans as tactics to prevent legitimate unionization. In view of this ambiguous intent of employer-initiated programmes, a series of such joint decision-making structures have been kept outside our present purview. Our focus instead is on government policy efforts. Indeed, a supportive legislative environment is instrumental in ensuring statutory rights of workers above and beyond their contractual rights acquired through private negotiations with employers.

6 The reasons for the visible turns in state activities were quite different for the two countries though. In Sweden, Social Democrats came to power for the first time in 1932 and then eventually consolidated their position over an extended period of time. This era marked the beginning of Social Democratic dominance in Swedish politics and coincidentally the inaugaration of progressive reforms at the workplace. In the U.S. policy history too during the New Deal era of the 1930s, the most sweeping pro-democratic legislations were enacted in the field of industrial relations.

7 Grossly simplified, tax rules are set up such that they lower the user cost of capital and thus stimulate investment. The process by which the reduced cost of capital redirects profits to investment is intricate, consisting of several elements in the tax code such as depreciation allowance, investment credits, other exemptions as well as the statutory tax rate, yielding finally an effective rate that captures the net impact of these rules.

8 Studies that have calculated METR in the United States and Sweden include Auerbach (1983), Bergstrom (1982), Hulten and Robertson (1982), King and Fullerton (1984) and Sodersten (1984) among others. The time series data on tax rates used below are culled from these published sources.

9 Put concretely, we undertake a chronological survey of four specific categories of labour law relating to : scope of bargaining, unions and members, immunities and liabilities in industrial action and realtive power of employers and workers. This categorization is adopted from Freeman and Pelletier (1990). We realize that other aspects of 'industrial relations' are important as well. Our study does not deal with all these factors. Only those statutory rules that directly pertain to collective control of workers and their representatives are discussed.

10 This measure is a variant of the index used in time series research by Hernandez (1985), and Freeman and Pelletier (1990). While their index measures absolute favourableness of the legal climate, the index constructed here records change in favourableness. For a comprehensive reading of the developing labour law in the two countries, we

examine not only the statutory language of the legislature, but also the decisional language of the court (the Supreme Court in the case of the U.S., and the Labour Court in the case of Sweden). The index compiles a group of landmark cases. A detailed description of the relevant legal changes and the reasoning behind the manner in which the index is constructed will be available to the reader upon request. The larger the value of the index, the more is the congeniality of the legal environemnt.

11 The relevant Acts are of 1981 and 1982. The 1986 Tax Act falls outside the timespan covered here.

12 The data for the period 1935-1950 are not available.

13 A revealing set of journal article titles conveys this sentiment: "Killing Unions with Kindness", The Guardian, Jan.4, 1982, "It Isn't Labor Day", Nation, 1978, "Unionist in Reaganland", New Yorker, Sep.1981.

14 The essence of the possibilist approach, as Hirschman (1971) puts it, is to widen the limits of what is perceived to be possible in between long-standing dilemmas, rivalries and trade-offs.

15 An interesting point to note is that the tax system is skillfully structured to put massive tax burden on non-productive stagnant wealth, but not on capital that is reinvested. Hence the interesting comment from an expert on Swedish taxation, "Swedish taxes are often blamed when entertainers, movie directors and tennis players emigrate. Owners of large manufacturing interests, in contrast, are much less inclined to leave Sweden because of heavy taxes." (Steinmo 1988, pp.406-407)

16 The 1976 election was the first time in 44 years that drove Social Democrats out of power. The party lost second election in a row in 1979.

17 The data used here are drawn from several published sources. The problem of the absence of comparable data which plagues cross-national research is severe. The data begin in 1954 and are available (though intermittently) through 1985. Corresponding figures for the earlier decades are not available.

18 The 'abnormal behaviour' of the curve in the diagram for 1977 is explained by Bergstrom (1982) on account of the fact that 1977 was an extremely bad year for profits and that tax payments were twice as large as profits. This highly irregular event is ignored in our analysis as an 'outlier'. In fact, data on decades presented by Sodersten and Lindberg (1984) indicate an overall improvement in the tax climate from the 70s to the 80s.

19 Comparatively put, Swedish workers' success in eliciting adequate policy responsiveness from public officials in respect of economic gains and 'social wage' benefits is remarkable as well. Our focus here is, however, on workers' control over their work environment.

20 As sketched below, the legislative effort at industrial democratization, though varying in its intensity of support, has never rolled back any of the reforms, hence justifying the label progressive.

21 The Saltsjobaden Agreement, signed between SAF and LO, elaborated the basic terms of relationship between labout and management. The tacit understanding in the Agreement was that the parties in the labour market would avoid using government power to interfere in the relationship between them.

22 Interestingly, the sweeping labour laws of the 70s enjoyed the support of practically all major parties. Even the 'bourgeois' (the conventional label for right of centre parties in Sweden) parties had no objection to employee representation on the boards or the Co-determination reforms. In short, the imperative of investment inducement has not posed any fundamental obstacle toward creating a 'democracy-friendly' labour policy environment.

23 The mid 70s attracts our attention in particular. This period has witnessed accelerated legislative effort to enhance workplace democracy as well as generous tax stimuli to corporations. This era bears testimony to an assertion that modern democratic state can go a long way in simultaneously stimulating growth and promoting democracy.

24 On the mutually reinforcing nature of voice and exit capacity of workers and the related possibility for the government to induce worker participation, we comment in the next section.

25 As an aside, we would like to briefly comment on two related arguments about Sweden's successful accommodations of polyarchal and market forces. First, it is often argued that the so-called 'Swedish way' of altering trade-off is a singular escape from an otherwise intractable dichotomy. But the labour policy pattern and legislative

initiatives in many other European countries also show similar developments in terms of power-sharing at the level of industries. The institutional features that allow the state managers to mitigate the market constraint are present in varying degrees in many European democracies. Second, it is often held that the remarkable Swedish record has been purchased at a substantial price and that now the signs of an aging system are appearing on the surface (for example, problems with the centralized bargaining system, decline in the Social Democratic support base, dramatic increase in unemployemnt rates and so on). Our response to it is that these 'pains' notwithstanding, the basic outline of a reformist state has remained in place for a considerable period, sufficient enough to question the prophecies about the foredoomed failure of Swedish experiments.

26 The incentive effects of democratic participatory schemes on worker performance are being increasingly emphasized by theoretical perspectives of both left and right.

27 This argument, going back to Karl Marx, has been reincarnated in some recent works. See Bowles (1988), Bowles and Gintis (1984), Offe and Wisenthal (1980) among others.

28 Throughout the advanced industrial economies, the accrued skills of the workforce increasingly tend to displace plant and equipment as the key assets. A 'good business climate' in these economies now include not only low wages, few regulations, low taxes and generous subsidies, but also a skilled, educated labour pool. In a special sense, skilled workers appear to have become capitalists. Surely, we are not making a naive argument that 'every worker is a capitalist'. Even an educated, skilled workforce, in the absence of proper institutional resources, may not carry any weight in the industrial world, as the US case has revealed. But with the right institutional arrangement in place, workers may command an 'exit' capacity which in turn will motivate state managers to pay attention to their aspirations and demands.

29 The dot in the argument of f corresponds to the variables K and L.

30 The two works on which we heavily rely are Bates-Lien study (1985) and Przeworski-Wallerstein study (1988). In defining the utility functions of capital and labour, we follow a variant of their formulations.

31 The appendix where we establish this assertion by assuming some specific forms of utility functions will be available to the reader upon request.

32 The inspiration of this line of research comes from Lindblom's ground-breaking work on business-government relations. The following rendition is primarily based upon his thesis.

33 Since pro-democratic labour laws enhance workers' voice, these policies are expected to elicit higher level of worker performance.

34 Since in the long run tax benefits get translated into an improvement in workers' material well-being, workers are not likely to respond to tax concession policy in a negative manner; instead they will acquiesce in investment stimulants and continue to contribute positively to the production process.

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FIGURE 1

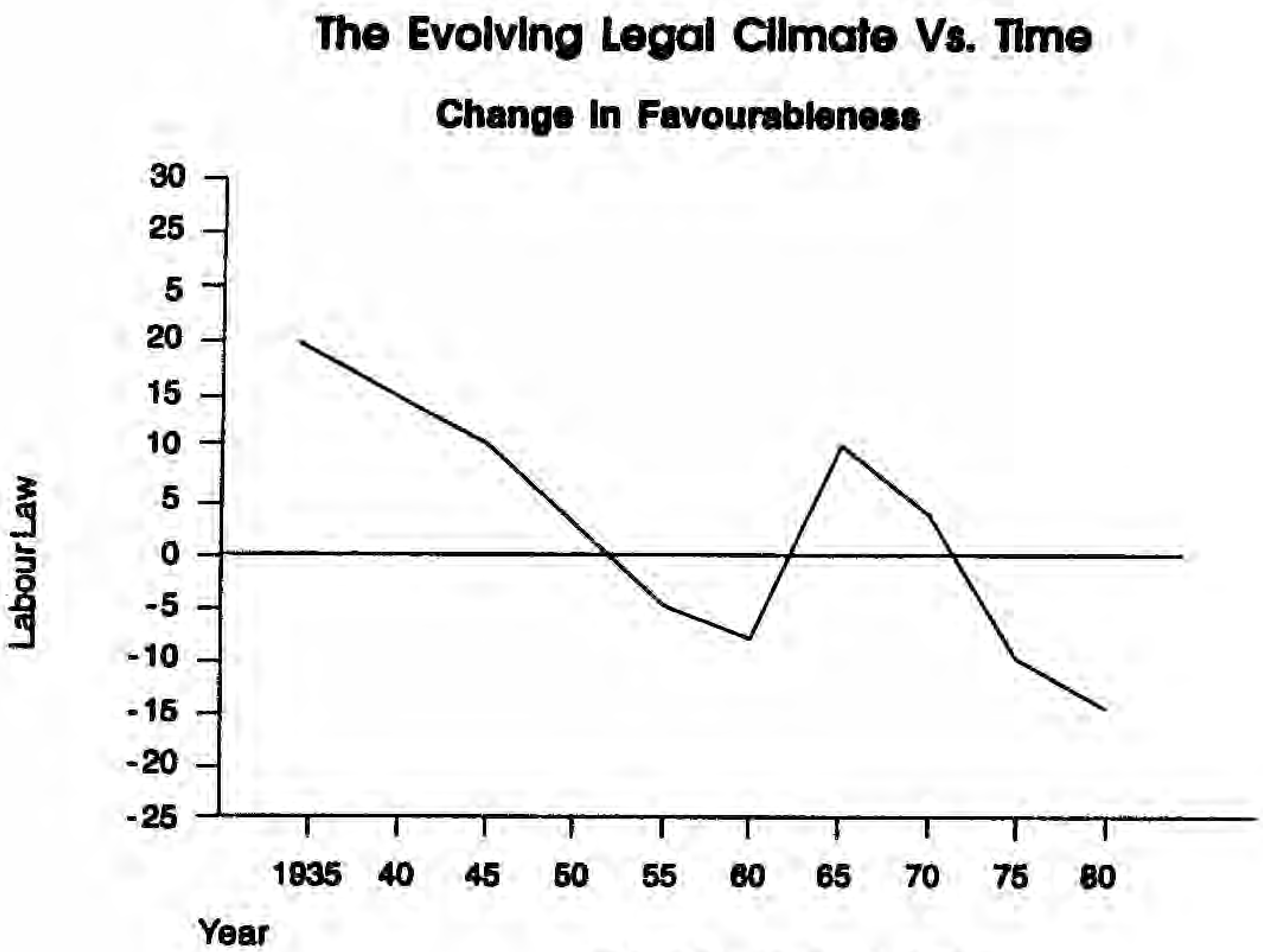


FIGURE 2 : THE U.S. CASE

Corporate Tax Climate in Sweden

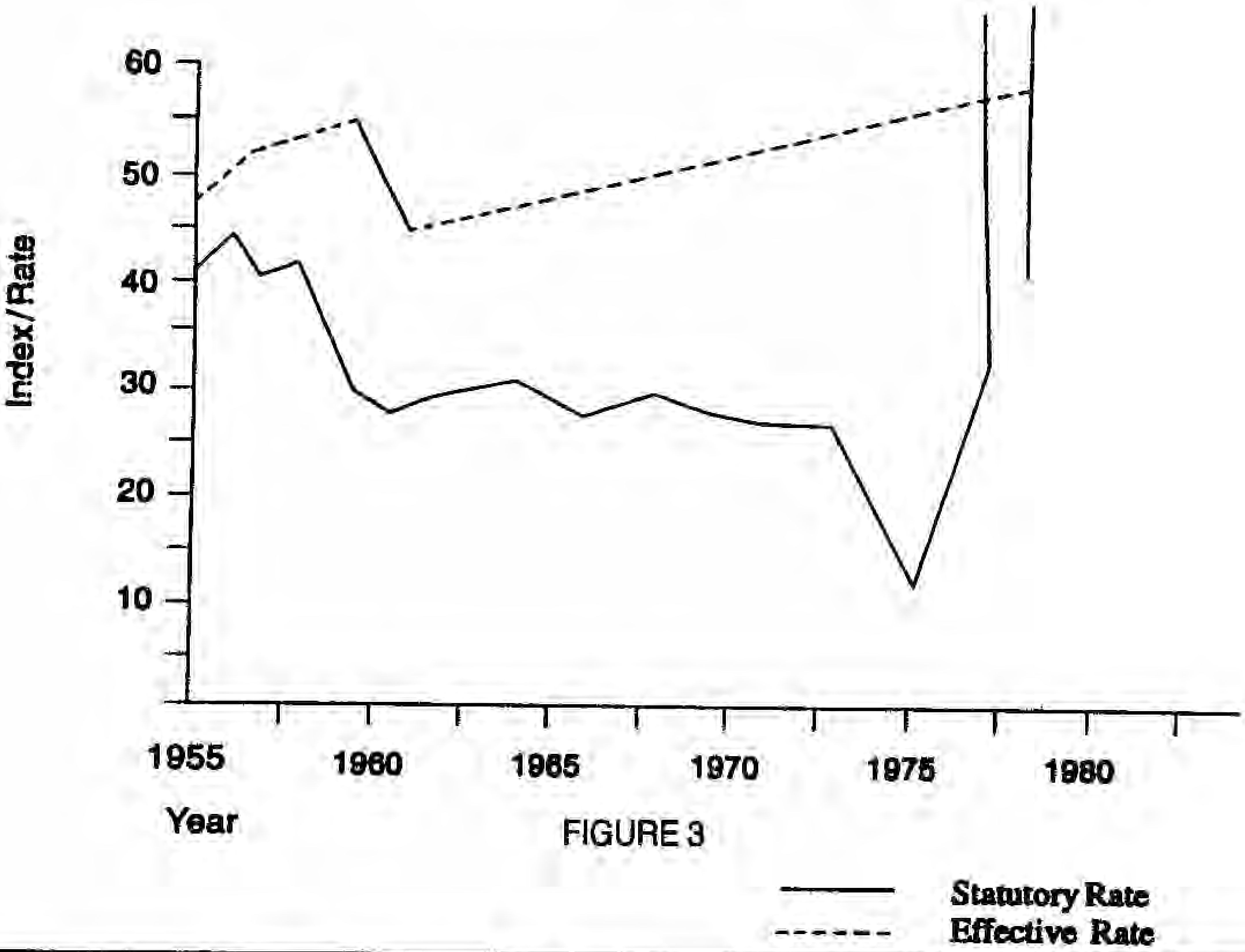


FIGURE 3

Change in Favourableness of the Legal Climate

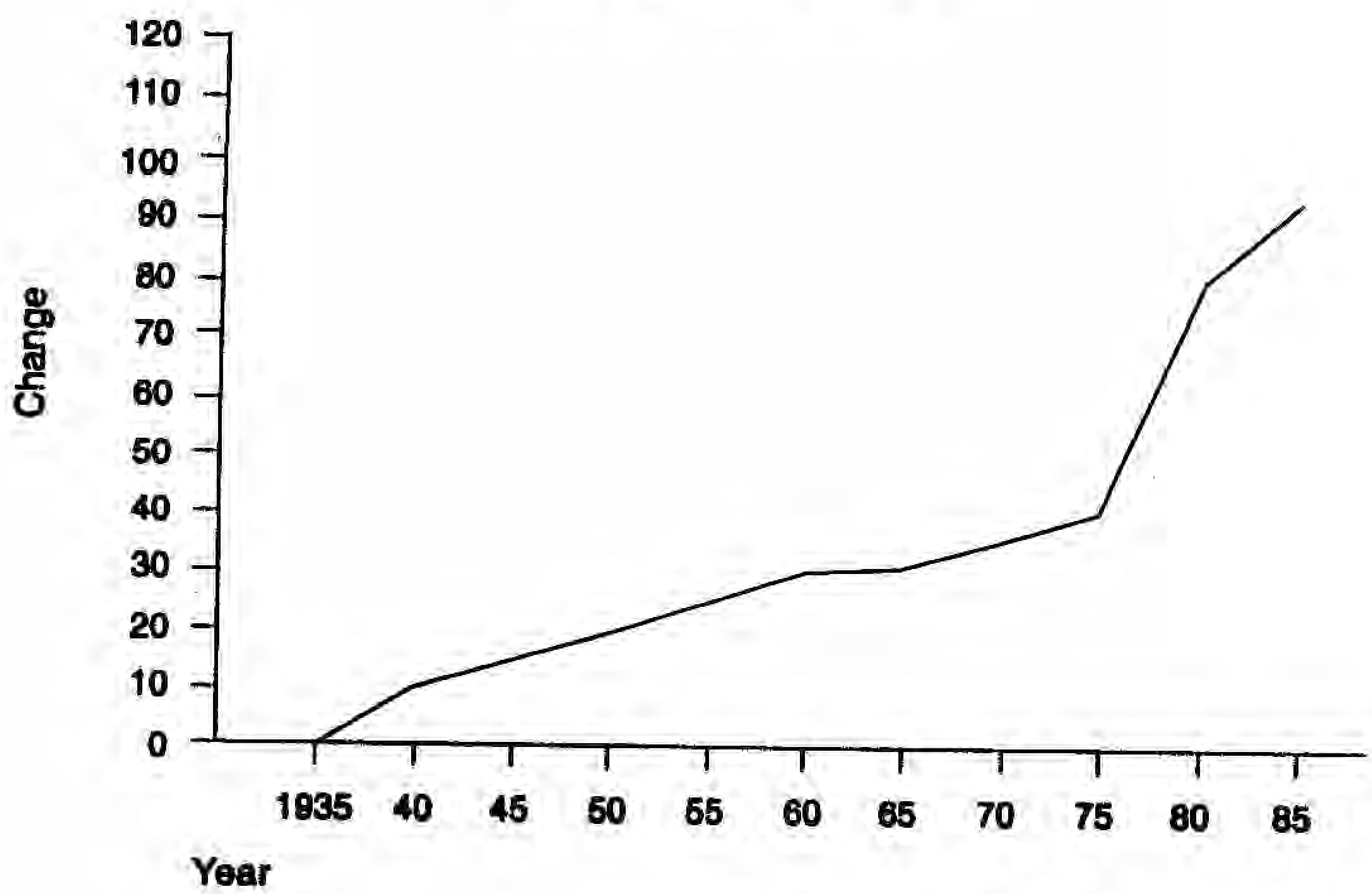
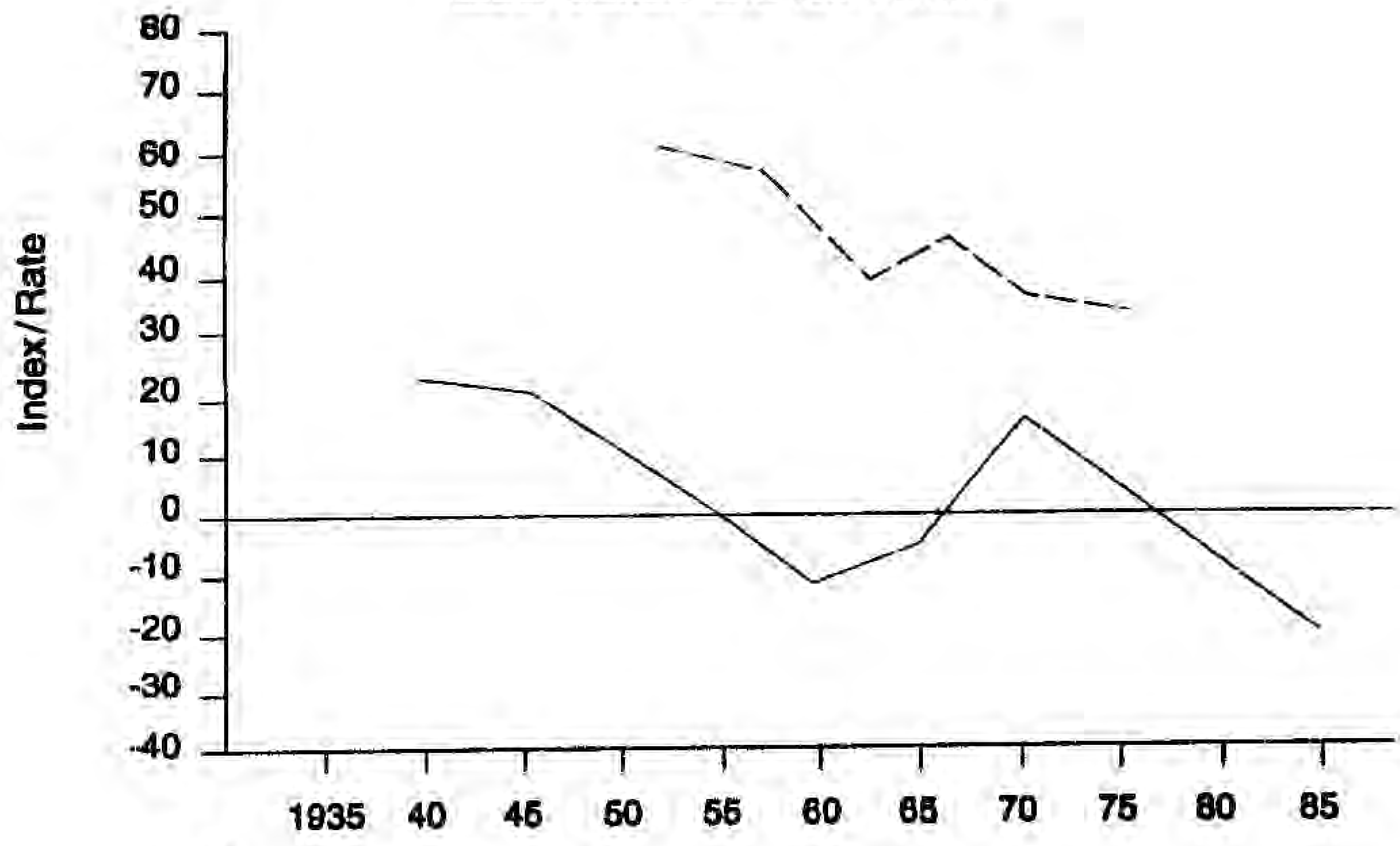


FIGURE 4 : THE SWEDISH CASE

Change In Favourableness
Labor Climate and Tax Climate

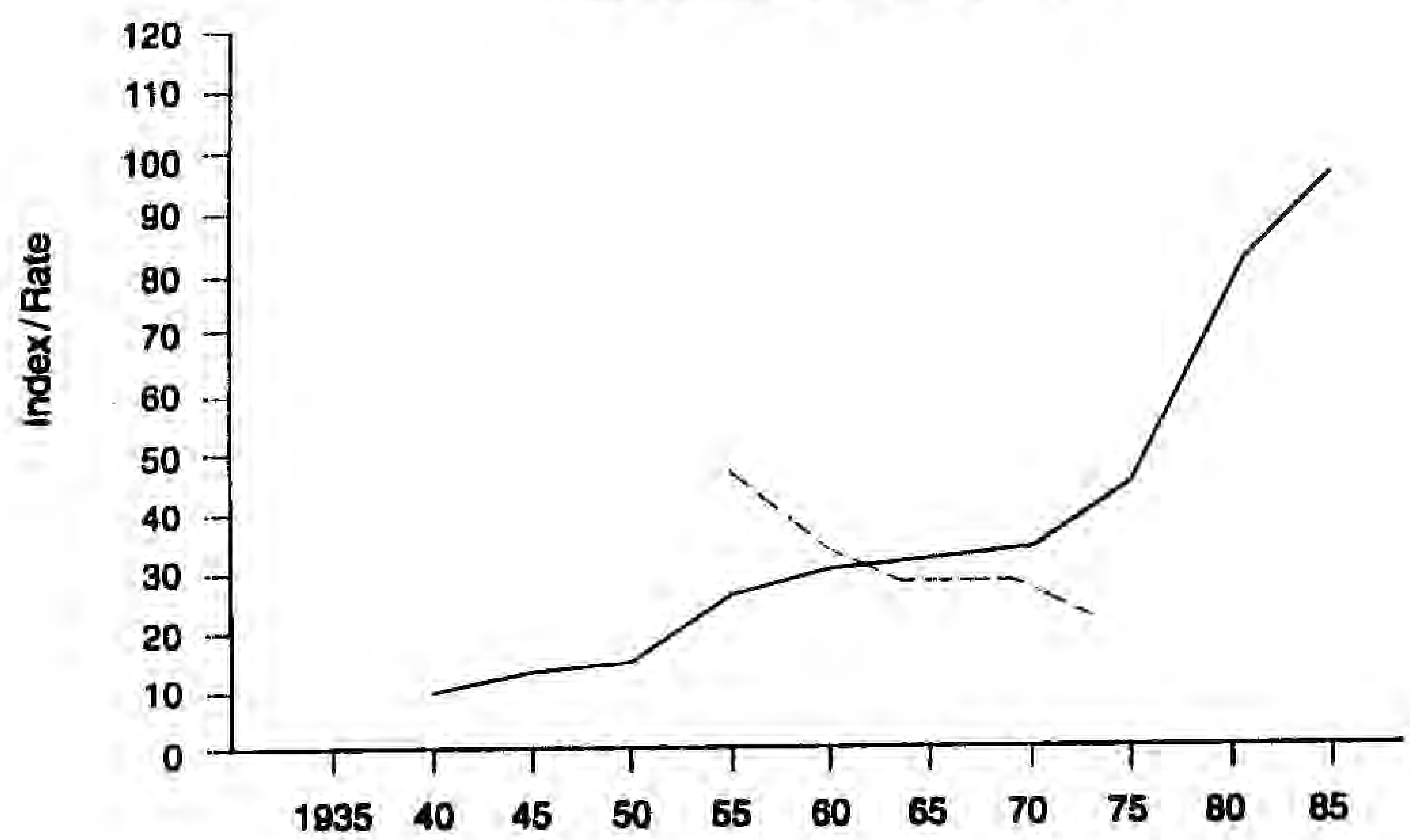


Year

FIGURE 5 : THE U.S. CASE

Legend
———— **Labour Law Index**
------ **Effective Tax Rate**

Change In Favourableness
Labor Climate and Tax Climate



Year

FIGURE 6 : THE SWEDISH CASE

Legend
———— **Labour Law Index**
------ **Effective Tax Rate**