The Nordic model: miracle remedy for prosperity?

Key words: Nordic model, Scandinavian model, Welfare State, labor market, free trade, immigration, social mobility

Summary:

- The “Scandinavian model”, which associates a universalist Welfare State with a highly liberal environment, is the symbol of the success of the Nordic countries in the prosperity and well-being rankings;
- This model is based on a common history of low class differences. This element has been the driver of a strong social citizenship and a highly democratic governance system based on political consensus and social arrangements;
- The willingness to balance the public accounts after an episode of overheating of the Scandinavian welfare states in the 1990’s has also led to a budgetary and fiscal rigor which has helped these countries to overcome the most recent crisis;
- However, a growing globalization which penalizes the Scandinavian industrial champions and an immigration which challenges the redistribution model and the Nordic cohesion represent the biggest threats these Nations have to face in the coming years.

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Benefitting from high living standards and low income disparity, constantly topping the classifications of the world’s most prosperous nations and the world’s happiest people, Scandinavian countries seem to have found the ideal economic model in a context where state intervention, tax and labor market policies often lead to sterile political debates and contradictory and inefficient solutions.

A role model for many reformers, the Nordic countries (Norway, Sweden, Denmark and Finland) are regularly quoted as examples especially when it comes to reforming government. However, the Nordic model cannot be reduced to a “high-tax high-spend” welfare state – as liberals often tend to. Indeed, as we will develop below, it consists in a particular and equilibrated combination of a universalist welfare state promoting individual autonomy and social mobility, a system of collective bargaining on the labor market side, all within an environment committing to private ownership, free markets and free trade. However, a thorough analysis of this “ideal” model raises several questions: is it as “ideal” as the economic and welfare indicators show it? Could it be replicated to other countries? And in a context marked by accrued economic uncertainties, can it be sustained over the long term?

An ideal “one-size-fits-all” model?

As Stein Kuhnle (political scientist at the University of Bergen) describes it, the Nordic welfare model is actually based on three major statements: Stateness, Universalism and Equality. Stateness refers to the extensive prevalence of the State in welfare arrangements through extensive public services and public employment, and in many taxation-based cash benefit schemes; Universalism refers to the principle of universal social rights extended to the whole population – contrary to typical means-tested schemes (“all benefit: all are dependent; and all will presumably feel obliged to pay” is the rule); eventually, Equality refers to the historical inheritance of the Nordic countries of fairly small class, income, and gender differences, a characteristic that still symbolizes these countries today.

This original system is deeply rooted in a combination of historical and geographic specificities, and this is one of the reasons why it would be hard to be replicated elsewhere. Indeed, Scandinavian countries have developed around a history of family-driven agriculture (contrary to the majority of European countries centered on large corporate-owned farms), resulting in nations of small entrepreneurial enterprises directed by citizens facing the same set of challenges and for whom solutions benefitting to one citizen are likely to benefit to everyone. As a consequence, citizens trust more their governments and willingly choose to pay higher taxes in exchange for benefits that they and their family members will get to enjoy; the resulting public services, such as education and healthcare, are of such high quality that private enterprise has no reason to offer these services or room to improve them. Also, some cultural idiosyncrasies have been a key element in the development of a strong State in Scandinavia.

1 Particularly the preeminence in Nordic countries of Lutheranism, a religion that promotes state involvement in economic and social life
All these historical and cultural elements have led to a high social citizenship, which draws upon a very equalitarian society (see graph above), can also be seen today by the very high rates of social mobility (with the notable exception of immigrants, as we will develop below) and female labor-force participation, but also by a higher trust in strangers and in the government (lower transaction costs, wide acceptation of government decisions, more people pay their taxes), and a strong belief in individual rights.

Source: OECD

Reading: 0 = perfect equality / 1 = perfect inequality
The other consequence has been the emergence of a **highly democratic governance system**, particularly in the 1930’s through national class compromises by trade union federations and employers’ associations, and political compromises across parties at the parliamentary and governmental levels\(^2\). These changes have led to a “consensual governance” system, particularly distinguishable in the labor market, where tripartite arrangements between governments, trade unions and employers’ associations ensure democratic governance, efficient conflict resolution and policy legitimacy as basis for political decision-making\(^3\). The high historical prevalence of coalition governments (and even minority governments) is also an illustration of this consensual governance system, sustainable political decisions needing parties in advance consulting each other to be made in a climate of mutual trust\(^4\).

Eventually, an impeccable transparency remains as the best epitome of this democratic governance system: still in Sweden, every citizen has access to official records and spending; it is no coincidence that Scandinavian countries are among the less corrupt countries in the world (in Transparency International’s 2015 Corruption Perception Index, Denmark, Finland, Sweden, and Norway were ranked among the top 5 least corrupt of the 168 countries evaluated). One could also argue that the Nordic countries are small and unitary, which makes decision-making processes easier than in big and/or federal states.

**“Democratic socialism” or “Social-democracy”?**

Liberal opponents to this model have nonetheless pointed the low economic incentives it provides, as well as the lack of competitiveness due to the high government spending, which consumes resources that could be more efficiently allocated by market forces and because the accompanying high tax rates discourage productive behavior; they also consider that this welfare state model redistributes assets between consumers and investors, limits the amount of money available for personal spending and consumption and encourages reliance on government-subsidized programs. Noting that the public sector in Sweden, Denmark, Norway, Finland, and Iceland consumes, on average, more than 48% of economic output (compared to 37% in the USA), that their tax burdens

\(^2\) To that extent, see the book “Sweden: The Middle Way” written in 1936 by the American journalist Marquis Childs, which accurately describes the “Third Way” Sweden had chosen between the USA and the USSR though a “strong cooperative movement and active government involvement in managing the economy”

\(^3\) The very high percentage of workers belonging to a labor union in the Nordic countries (69% in Finland, 67.7% in Sweden, 66.8% in Denmark and 52.1% in Norway) is a clear proof of the strength of these tripartite arrangements. However, several studies show that this system is increasingly eroded by the development of new technologies, the integration to financial markets and the growth of the services sector over the industrial sector (see for instance the study of the Harvard Academic Torben Iversen)

\(^4\) The “Rainbow Coalition” (comprising the parties of the communists, social democrats, liberals, and conservatives) set in Finland in the aftermath of the USSR collapse in the early 1990’s is an accurate illustration of this consensual mentality.
are among the highest in the world (50.9% of GDP in Denmark, 43.9% in Finland and 42.7% in Sweden), and that Nordic countries employ on average 30% of their workforce in the public sector, compared with an OECD average of 15%, it is an easy way to blame the overwhelming size of the State for a pretended poor performances of Nordic countries.

But even though this model is based on an extensive welfare state, it cannot be considered as a form of Socialism – as several politicians tend to call it. Indeed, as the Foundation for Economic Education points out, Scandinavian countries are far from the definition of Socialist countries: means of production are primarily owned by private individuals, and resources are allocated to their uses by the market. Beyond these elements, in the rankings for globalization and ease of doing business, these nations are almost always at the top of the ladder. On the labor market side, minimum wages are decided by collective-bargaining agreements between unions and employers, and not through government-imposed floors (see above). In the same vein, Denmark and Norway allow private firms to run public hospitals, and Sweden and Iceland have partially privatized their social security retirement systems. Eventually, the best proof of the free-trade background of Nordic countries might be Volvo’s buyout by Geely of China in 2010 and the bankruptcy of Saab in 2012 – that Swedish government did nothing to prevent even though they were two of its most iconic companies.

Actually, even though liberalism has long been a core value (Sweden for instance abolished preference for aristocrats in handing out top government jobs and created a meritocratic and corruption-free civil service as soon as in the 1840’s), this progressive leaning towards free markets dates back to the early 1990’s financial crisis, which strained Scandinavian welfare states and forced them to increase taxes drastically to keep their model alive. Throughout all the period from the end of WWII to the beginning of the 1990’s, the consensus in Scandinavia was about a growing part of the State in the economy, especially in Sweden where the Social Democrats, who governed quasi-uninterruptedly during this period, kept increasing public spending and taxes. However, the collapse of a financial and housing bubble in 1993 has forced the Swedish State to scale down their generous Welfare State system in a context of lower growth and growing unemployment, and to consolidate public accounts: as of today, Sweden’s public spending has decreased to 49% of their GDP, and their corporate tax rate (22%) is below America’s. The priority given to the budgetary equilibrium though strict fiscal rules and banking regulation in the aftermath of this major crisis has proved to be efficient (see graph below) and it has allowed the Scandinavian countries to get over many hurdles such as the recent subprime crisis.

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5 [http://www.heritage.org/index/explore?view=by-variables](http://www.heritage.org/index/explore?view=by-variables) (see the column “Tax burden as a % of GDP”)
As of today, Denmark, Sweden and Norway are all rated AAA by the three major rating agencies (S&P, Moody’s and Fitch), Finland being rated just one notch below. Sweden, Norway and Denmark also benefit from individual flexibility in their monetary policy compared to the Eurozone, the first two having recently implemented Quantitative Easing monetary policies. However, the necessity for the Swedish Central Bank to get their repo rate into negative territory in 2014 (following the ECB’s QE which has dangerously appreciated the Swedish krona against the euro, in a country highly turned to exports) shows the small leeway the Scandinavian monetary policies can enjoy, the countries in which they operate being economically integrated to the Eurozone. Eventually, Norway’ dependence to oil prices is attenuated by the sovereign wealth fund they have progressively developed (912 billion USD as of February 2017). We can nonetheless mention a growing risk of housing bubble in Norway and above all in Sweden (see graph below), fed by very favorable credit conditions (extremely low rates in the QE period, many variable rates credits, etc.); however, the stress tests suggest that the risk of “hard landing” (rise in interest rates, macro-prudential policies, change in households’ confidence, etc.) would be limited by sounder public finances and more severe banking regulation policies. This housing bubble has however a negative effect on the expansionary monetary policy in that it prevents this policy from stimulating inflation, a large part of the households’ expenses often being dedicated to reimbursing mortgage loans.
The term that would best describe the new model would actually be “social democracy”, a system in which the government aims to promote the public welfare through heavy taxation and spending, but within a growing framework of a capitalist economy. The epitome of this equilibrated system that tries to limit capitalism’s harsh effects is the Danish “flexicurity” policy on the labor market, which makes it easier for employers to sack people but provides support and training for the unemployed. The values of pragmatism, efficiency and transparency have helped the Nordics overcoming several major challenges, such as the recent financial crisis. However, several unprecedented threats are progressively appearing, questioning the sustainability of the Scandinavian model.

**An unsustainable model in the long term?**

Indeed, beyond the debate on the replicability of this model, the central question is all about its sustainability; actually, even though the financial crisis did not seem to jeopardize their economic structure, some major threats are weighing more and more on it.

The first threat is **rampant globalization**, which puts a risk on the big companies whose ability to generate enough money to support the state has always been a key factor in the success of the Nordic model. The richness of Scandinavian strongholds in many domains, such as shipping (Maersk), toys (Lego), drink (Carlsberg), retail (Ikea, H&M), machine tools (Sandvik), etc. is a strong asset, but
tough competition from rich-world rivals (see for instance Finland’s Nokia vs Apple in the smartphones’ market) and emerging-world new giants (see for instance Sweden’s Ericsson vs Huawei in the telecoms equipment) is becoming a heightened risk. However, the Nordics’ mentality of innovation (see graph below) and productivity, an intense presence in global niches and a consensus-based approach to management and investment in human capital (BCG indeed thinks the region has the world’s most skilled “low-skilled” workers) can help to compensate these risks. However, the chronic difficulties and the progressive offshoring of Nordic companies to countries where labor force is cheaper and markets are bigger sheds light on the inability of these countries to produce a new generation of successful capitalists as the State has grown bigger (proof is in Sweden, only 2 of the 100 biggest companies were found since 1970, versus 39 in California); a very big challenge to be observed as the trend is now to a reduction of the State’s role in the economy, will be to rely less on the same handful of capitalist dynasties.

Concerning the growing influx of immigrants, the issue is even much deeper, as it poses a problem to the redistribution system itself that lies at the core center of the welfare state. Indeed, the affordability of the Nordic welfare state systems relies on the condition that a large part of the adults are in the workforce; but in Sweden alone, the gap in labor force participation is very important between non-European immigrants (of whom 51% have a job) and native Swedes (84% of them have a job). As Matz Dahlberg (researcher in Economics at Uppsala University) points out, the major risk of mass immigration in European countries is that it makes natives less supportive to income redistribution, which eventually poses a threat to countries like Sweden where homogeneity and equality are the pillars of the economic model. This issue has even been amplified by the
recent refugees crisis, when Scandinavian countries were literally outreached by the tides of asylum-seekers, Denmark even taking strong and controversial measures questioning their tradition of generosity and openess.

**Conclusion**

Are the Nordic countries a model for the rest of developed countries? We may answer yes, for several reasons: first, they top the rankings for most of the elements that make a country successful – well-being, education, health, environment to say the least; second because they are also performing (very) well on the economic side. These countries have developed a true model for the role of government in the economy, in which the State’s job is to invest in human capital and protect people from the disruptions that are part of the capitalist system (high income disparity, lack of affordable quality healthcare and education, deteriorating social safety net, lack of retirement security, etc.) while promoting individual autonomy and social mobility.

But even though, as we have pointed in this article, a large part of the Scandinavian system is sui generis and reflects the Nordics’ long tradition of good government, which emphasizes not only honesty and transparency but also consensus and compromise, this model could be an inspiration for most of the world, notably because the Nordics are already successfully dealing with most of the problems the other Nations will be facing in the very next years, for instance reaching the limits of the “Big Government” and overgenerous entitlement programs in a context of growing debts. What if the economists should get their compass instead of their models, and follow the North?

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