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NORDIC ECONOMIC POLICY REVIEW

Introduction

Torben M. Andersen and Jesper Roine

The Nordic welfare model in an open European labor market

Bernt Bratsberg and Knut Roed

Future Pathways for Labour Market Policy: Including the Excluded

Michael Svarer and Michael Rosholm

Economics of Innovation Policy

Tuomas Takalo and Otto Toivanen

Taxing mobile capital and profits: The Nordic Welfare States

Guttorm Schjelderup

Nordic family policy and maternal employment

Julian V. Johnsen and Katrine V. Løken

Education and equality of opportunity: What have we learned from educational reforms?

Helena Holmlund

Retirement and Health in the Nordic Welfare State

Nabanita Datta Gupta and Bent Jesper Christensen

The future of Welfare services: How worried should we be about Wagner, Baumol and Ageing?

Andreas Bergh

Ethnic fractionalization and the demand for redistribution – Potential implications for the Nordic model

Johanna Mollerstrom

The social upper classes under Social Democracy

Kalle Moene

1. Introduction

1.1 Whither the Nordic Welfare Model?

Torben M. Andersen, Department of Economics, Aarhus University and Jesper Roine, Stockholm Institute of Transition Economics, Stockholm School of Economics

The Nordic Welfare Model frequently attracts international attention and is by many seen as a social model to be inspired by or even to be copied. In recent years, the “Nordic Way” has been a topic for discussion at the World Economic Forum and it has even appeared on the cover of *The Economist* under the heading “The next supermodel”.¹ Somewhat paradoxically, however, the debate in the Nordic countries often features skepticism on the future of the model. Does this reflect a timely concern voiced by those best placed to see what is going on, or are the doubts on the contrary a result of model-hypochondria?

A first caveat – or perhaps part of the answer – has to do with the meaning of the very concept “Nordic welfare model”. Is it really meaningful to talk about the existence of such a thing? Is the term well-defined given how large the differences are between the Nordic countries and given the major policy shifts in the past decades? The answer clearly depends on what one includes in the meaning of the model concept. If one thinks that it is associated with a certain set of specific policies or certain levels of tax rates or benefits, then clearly the concept is questionable. These things have indeed changed over time and are also different across the Nordic countries. For example, unemployment in-

¹ The Economist, 2 February 2013, <http://www.economist.com/news/leaders/21571136-politicians-both-right-and-left-could-learn-nordic-countries-next-supermodel>

insurance is voluntary in Denmark, Finland and Sweden, but mandatory in Norway. Pension systems are fundamentally different spanning from a large role to funded occupational pensions in Denmark to a notionally defined contribution scheme in Sweden. While tax burdens are high in the Nordic countries (except for Iceland), the tax structure differs with Denmark having the larger share of tax revenue accruing from direct income taxes and value added tax, while Sweden raises much more tax revenue from social contributions.

However, in a longer perspective such a focus on certain policies would seem odd. If one were to look at reforms and levels of tax rates and benefits over the whole history over which the concept of a “Nordic model” has been identified and discussed, these have varied a lot. Indeed, continuous change has been a distinguishing feature of the model, and the changes over the past decades are not in any obvious way larger in magnitude than those in the preceding decades.

If one instead identifies the Nordic model as being concerned with a number of broader principles and goals in terms of outcomes, the concept becomes more well-defined. What matters then are the overall objectives and the overall design of the package. Here the complementarity between policies and institutions is crucial. It is not the ingredients, but the overall packaging, which makes a difference in terms of final outcomes. With this kind of perspective it also becomes clear that the naïve “copy and paste” perspective often taken in comparative policy discussions focusing on a single or few policy instruments is misleading since it overlooks the complementarities between the different policy elements. From this point of view the Nordic model should not be defined or assessed in terms of specific policy instruments, what matters is the overarching objectives. Goals – such as equal opportunities in life regardless of family background, the eradication of poverty, gender equality, the lowering of income inequality, etc. – as well as some principles – such as individually based universal rights to things such as health care and education, well-organized labour markets, etc. – have

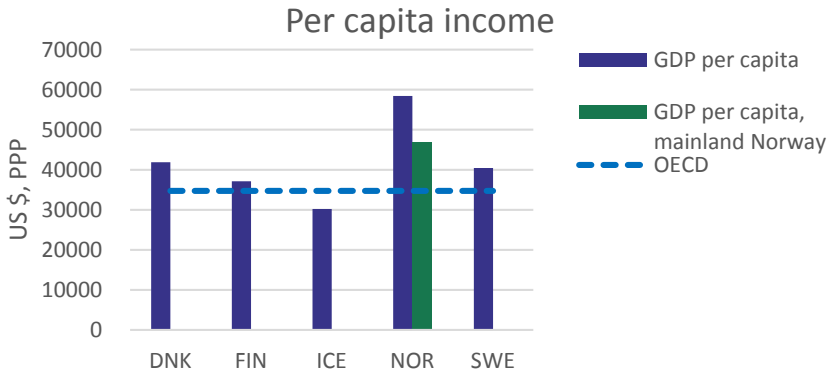
remained largely stable, while the specific policies and instruments to reach them differ across time and countries.²

In terms of economic performance the Nordic countries, like most others, have seen good and bad periods, but the Welfare Model – defined in terms of its goals rather than a fixed set of policies – has proved resilient. The Nordic countries stand out today as they did decades ago as being countries with comparatively high living standard and a relatively equal distribution of income. In the jargon of economics, the Nordics seem to have found a way to balance concerns for efficiency and equity. The public sector is large, hence the tax burden is high, and yet the Nordics rank in the top for various indicators of economic performance and competitiveness.³ Figure 1a–c depicts a few select indicators often used to compare countries along the efficiency and equity dimension. The Nordic countries are high income countries, and have high employment rates, especially for women. Income inequality and poverty is low in international comparison.

² Of course these things are (and have been) debated (see e.g. Andersen, Roine and Sundén (2014), Chapter 2, for an overview of different views of the Nordic welfare state). The main point here is to emphasize that the model should be understood in terms of broad goals rather than in terms of specific policies.

³ In the most recent version of the Global Competitiveness Index 2014–2015 ranking Finland placed 4, Sweden 10, Norway 11, Denmark 13 and Iceland 30, out of 144 countries.

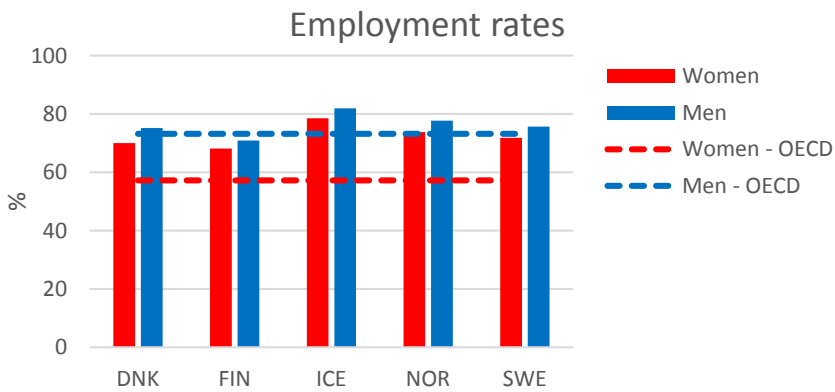
Figure 1a: Performance indicators for Nordic countries – Per capita income



Note: Income per capita is measured in USD PPP corrected. Norway-mainland is GDP corrected for the importance of off-shore oil and gas extraction, 2010.

Source: Data from www.oecd-ilibrary.org

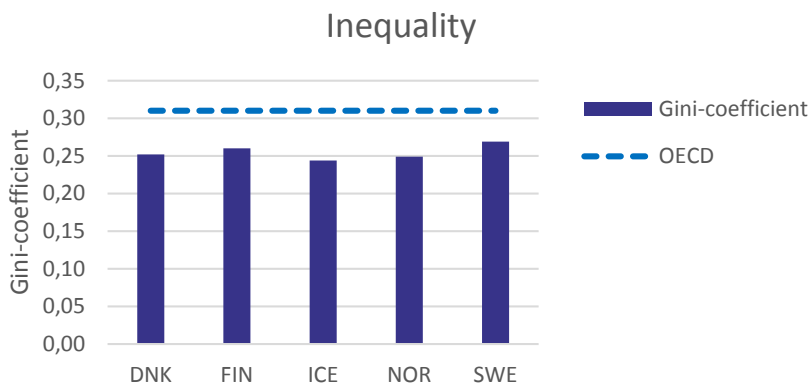
Figure 1b: Performance indicators for Nordic countries – Employment rates



Note: Employment rates for the age group 15–64, 2011.

Source: Data from www.oecd-ilibrary.org

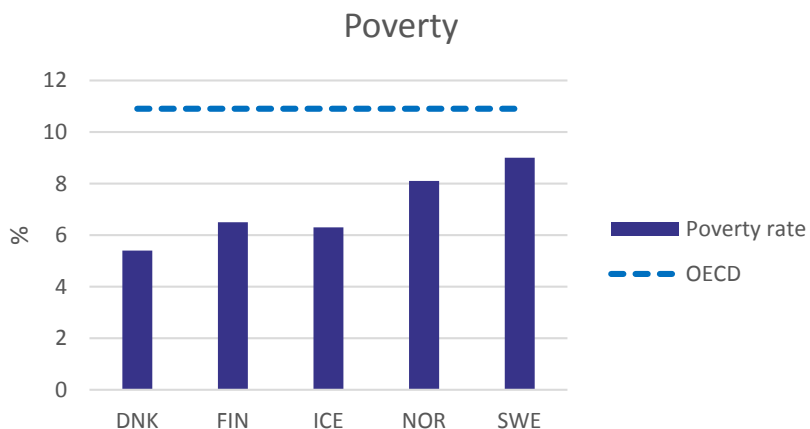
Figure 1c: Performance indicators for Nordic countries – Inequality



Note: Gini-coefficient defined over equivalised disposable income 2010.

Source: data from www.oecd-ilibrary.org

Figure 1d: Performance indicators for Nordic countries – Poverty

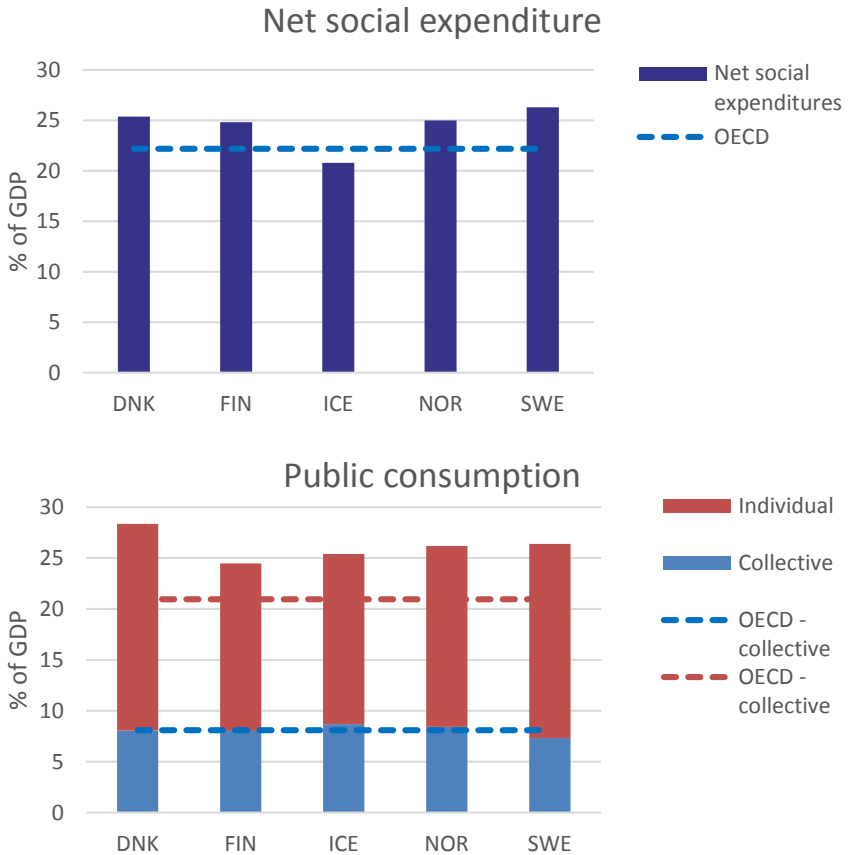


Note: Poverty measured as the share of individuals with equivalised income below 50% of median income.

Source: Data from www.oecd-ilibrary.org

Taxes are, no doubt, high in the Nordic countries, and taxes distort economic incentives. However, the effects of taxes cannot be seen independently of what taxes are financing. The two broad expenditure types relate to the social safety net and provision of welfare services, cf. Figure 2. The social safety net plays an important distributional role but it also provides insurance. The latter may have a direct welfare effect but also be conducive to flexibility and ensures that the costs of changes at the level of society are not fully carried by specific individuals. Welfare services include education, health and care. They are provided universally and at contemporary standards and meeting the requirements of most people. Welfare services are important from a distributional point of view, and in terms of ensuring equal opportunity. Clearly, these activities are also important for labour supply along both the quantitative and qualitative dimension. As examples, day care – which is also associated with other values in relation to family policy and social integration – promote labour supply, especially for women. Education is obviously associated with productivity but is also associated with e.g. later retirement. The complicated interrelation between the effects of taxes and welfare spending underlines the need to continuously recalibrate policies to find the right balance between concerns for efficiency and equity alongside various changes in society.

Figure 2: Public sector activities: social expenditures and public consumption



Note: Net social expenditures correct gross social expenditures for taxes on transfers to make data comparable between countries, where in some transfers are taxable income and in others they are not taxable income, see Adema *et al.* (2011). Public consumption is split between traditional collective expenditures, and expenditures on activities which can be attributed to specific individuals (welfare services). Data applies to 2011.

Source: www.oecd-ilibrary.org

Discussions on the future of the welfare model often has “competitive-ness” in the broad sense of the term as a common denominator. Can the Nordic countries remain competitive and thereby sustain a high living standards? Often this debate has the implicit premise that to remain

competitive we cannot deviate too much from other countries, and therefore the Nordic model is particularly vulnerable.

The concern for competitiveness is not new to the small and open economies of the Nordics. It has always been an overriding concern. But “being competitive” is not tantamount to “being alike” and implying that all social models have to converge. This view has no support in, for instance, trade theory stressing the importance of differentiation and comparative advantages. There is also an increasing understanding that different social structures and institutions can be a source of comparative advantages. A recent literature levy a critique on traditional analyses for having a too one-sided focus on identifying the optimal institutional setting, see e.g. Nunn and Trefler (2013). There is no specific institutional setting which is optimal. The reason is that various institutional arrangements have pros and cons, which may be a source of comparative advantage. Countries with flexible employment protection legislation and generous unemployment insurance may have a comparative advantage in industries with substantial short-term variation in demand and thus production, while countries with more strict employment protection legislation and less generous unemployment insurance may have a comparative advantage in production of commodities with less variability. As an example of this Cuñat and Melitz (2012) find in a cross-country study empirical support that countries with more flexible labour markets have a higher degree of specialization in sectors more frequently exposed to sector-specific shocks. This may be interpreted in the sense that the nature of shocks or needs for adjustment to some extent is endogenous, meaning that countries (or rather its companies in the private sector) specialize in the activities for which their particular institutional setting has a comparative advantage. This type of research is still in its infancy, but it is highly suggestive of why different institutional settings (welfare regimes) survive. The important lesson – repeating basic insights from trade theory – is that competitiveness is a question about comparative advantages.

Past performance is important, but the pertinent question is whether the Nordic Welfare Model is robust and resilient to various challenges including changing demographics, globalization, new technologies and environmental changes?

Society is undergoing various changes, some small, some larger, some come gradually and others in clusters. In the debate they are often labelled challenges, signalling that policy initiatives are required. Whether they are a challenge or a threat to the Nordic model as such is a different issue. To take an example, the issue of ageing is undoubtedly a very important policy challenge. The age composition of populations are changing, not least because longevity goes up (and is in itself associated with huge welfare gains). Clearly, the social contract has to be adopted to such a change. Although this may be politically difficult, it is not difficult in a technical sense, and a solution is clearly feasible without changing any fundamental properties of the model. One solution may be to increase retirement ages alongside increases in longevity and thereby ensure that the fraction of life spent in the labor market remains unchanged. It is not possible in any meaningful way to interpret this as a change in the basic principle of the model.

Another much discussed area is that of automation and digitalization and the impact this will have on all aspects of the economy, in particular on the future of work. This is a vast debate with many dimensions but it is interesting to note that some aspects of the challenge and some suggested solutions turn out to be much aligned with basic principles of the Nordic model. Predictions such as the need for continuous education throughout life and the need for individuals to be able to hold several jobs over a life-time, in fact, place demands on policy similar to those of a small open economy in an increasingly globalized world. Ideas such as “protect individuals, not firms” and “make sure the workforce has continuous possibilities to educate and re-educate themselves to meet new challenges” are not less familiar to the Nordic model than to other countries, rather the opposite. For sure, policy will have to change to adapt to new realities, but again, it is not obvious that these challenges make the model obsolete.⁴

Some challenges may be related to properties of the model. Immigration of unskilled or low-skilled individuals may be a particular prob-

⁴ Just as an example, in a recent issue of *Foreign Affairs* Colin and Palier (2015) outline some challenges in the “digital age” and arrive at the conclusion that aspects of the Nordic model are, in fact, better suited to “fostering a more fluid and entrepreneurial economy” than many of the alternatives discussed.

lem in societies with high minimum wages (no working poor), high qualification requirements for jobs, high employment rates for both genders etc.

In other cases solutions may also be model specific, as e.g. in relation to provision of welfare services like education, health and care, which are essential elements of the welfare state. Such welfare services may be subject to both Baumol's cost disease (relative costs increases over time since productivity increases are typically lower than for manufactured products) or Wagner effect (increasing demand for service alongside improvements in material living standard). While the drivers are universal, the solution is model specific, since the Nordic countries have opted for a larger public role in the provision of services

Society is undergoing large changes – as it also has in the past – not least those arising in the intersection between globalization and technological change which changes modes of production which on impact creates both winners and losers in the labour market. The derived effects also include new forms of employment, less stable employment relations etc. Left on its own this may be a source of increasing inequality. This raises questions for traditional distribution policies running via taxes and the social safety net, but also for the possibilities to actively counteract these changes via education, labour market and social policies. Maintaining a high employment level is both a value in itself related to social inclusion and equality, but the financial viability of the welfare model also depends on maintaining a high employment level.

These changes also have wider effects on the interface between markets, civil society and the family. Changed employment relations and demands in the labour market may affect the possibilities the individual has in balancing work-life and family-life. Families may also undergo changes (divorces) and there is an increasing trend in single-families.

Perhaps the most important aspect of the Nordic model should not be found in economic details but rather in the political economy sphere. It is sometimes denoted the "consensus" tradition which permeates industrial relations and politics. The political capital is large and this is reflected in an ability to undertake reforms. Rather wide ranking reforms of pension and retirement schemes have been implemented

smoothly in e.g. Denmark and Sweden, and they are among the few countries who have addressed the ageing problem.

In discussing changes or challenges, it is also worth pointing out that many of these are common to most countries or global in their nature. The need for changes and adjustments should therefore be seen in the perspective of the changes needed in other countries. It is not clear that the challenges are posing a larger problem for the Nordic countries. To list just a few, the US is facing a problem of steeply increasing inequality and segregation. Southern European countries experience an outflow of well-educated young and strong protests and retrenchment of reforms to address the ageing problem.

Globalization and technological changes are associated with collective gains but an unequal distribution of gains and losses. Welfare arrangement may contribute to compensate the losers and (re) distribute the gains, which in turn may be conducive to reforms. Clearly there is a hen-and-egg issue in the interdependence between welfare arrangements and ability to reform – the welfare state may create an environment in which it is easier to undertake reforms, but the reforms are also crucial for the development and viability of the model. How this relationship has been established and developed historically is in itself an interesting question, but beyond this volume to consider.

Rather than looking backward at past performance it is important in due time to consider changes in society and discuss how to address them. This volume addresses some topical issues on the future of the Nordic welfare model. It is, of course, by no means exhaustive, but instead covers a number of broad issues outlining what recent research has to say on them. Each paper is relatively short, given the width of each topic, and the titles of each contribution explain what the covered topic is, so rather than trying to summarize the contributions we hope that they all, together or individually will contribute to a better and more informed discussion about the future challenges, reform needs but also possibilities of the Nordic model.

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