

## Chapter 3

# Floating high

## How the Nordic model combines capitalist dynamics and worker security

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### Introduction

The performance of the Nordic model over more than fifty years seems to suggest that capitalist dynamism and worker security do not compete so much as complement one another. The model is more robust in the face of globalization than in the internal social changes it generates. Perhaps it should not be considered an end in itself, but rather a productive development strategy for countries that seek an egalitarian road to affluence.

At the very least, the Nordic experience speaks against those who claim there always is a trade-off between equality and efficiency in the development path of an economy. In this chapter I contrast such trade-offs with my own views on the Nordic model: First of all, the Nordic model may be seen not as a concession by employers to workers, but rather as a political and economic system that benefits both. Secondly, the rise of the model should be understood as a cumulative evolutionary process, and not as the result of intelligent design. Thirdly, the special form of equality that the model provides seems to stimulate rather than hamper innovation and structural change. Fourthly, rather than being threatened by globalization, the model may become a victim of its own success. Finally, instead of references at the end of the chapter, a list of research papers is provided where claims for this overview are further elaborated.

### Against the winds

The societal model of Northern Europe goes by many terms. While the Swedes traditionally have called it the ‘Swedish model,’ the Danes and Norwegians have insisted on the ‘Scandinavian model.’ More recently, representatives of the European Union have started to use the term ‘Nordic model,’ which now seems to be the most widely-used. Others emphasize that the model is common in Europe, but has attained its purest form in Scandinavia. Outside Europe, however, the model is best known as

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‘social democracy,’ a term most Europeans associate with specific political parties and ideologies, rather than with an economic and political system.

Whatever the name, the Nordic countries have for decades done remarkably well when it comes to achieving social goals of equality and worker security, without obvious macroeconomic costs in terms of inefficiency and stagnation; even though Denmark, Finland, Norway and Sweden all seem to violate what prominent scholars within the economics profession have long viewed as necessary requirements for an economy to prosper. Wage differentials are too small, taxes are too high, public sectors are too large, welfare states are too generous, and unions are too strong. Yet, what some economists see as a recipe for serious economic trouble seems in the Nordic countries to be consistent with high growth, low unemployment, low inequality, and a fairly efficient allocation of resources.

The economic growth in the Nordic countries has indeed been on par with the US, but without the wide social disparities of American society. Since the 1970s, rising inequality in the US has gone hand-in-hand with a widening of social cleavages and a decline in standards of living for at least one-third of the population. In contrast, most of Europe has experienced only a modest rise in inequality, but a sharp increase in unemployment. The Nordic countries, however, have combined social equality with good macroeconomic performance and close to full employment.

The lesson from all this is not that there is a universal positive relationship between social equality and good economic performance. The lesson is that under some institutional arrangements, equality and prosperity can work together and be mutually beneficial. Under other institutional arrangements this is not the case. A narrow economic approach that neglects institutional complementarities and social spillover does not capture such mechanisms, and can easily lead to misinterpretation of the Nordic society model.

## So what is a ‘society model’?

What is meant by ‘society model’ in this connection is neither a set of equations to be manipulated by economists, nor a role model that others should follow. It is an economic and political system, consisting of institutions and policies that simply fit together.

In terms of institutions, the Nordic model consists of encompassing labor market organizations, routine consultations between the government and organized interest groups, and a large welfare state. In terms of policies it consists of wage leveling through ‘solidaristic’ wage bargaining, a government commitment to full employment, and the provision of basic goods for all citizens as a right of citizenship.

In the labor market the encompassing union movement and employers’ association tend to take wages out of competition by way of centralized wage negotiations. The role of employers is often forgotten by both critics and admirers of the system. If the employers so desired, they could easily dissolve the system by withdrawing from central wage negotiations. Since they do appear at central

wage negotiations again and again, they reveal their preference for this kind of wage coordination over other feasible alternatives.

The routine consultations between representatives of governments and interested organizations are sometimes called ‘corporativism’ - an ugly misnomer for voluntary exchange of information and attempts to coordinate actions and beliefs. The consultations are important for consensus-building on economic conditions at home and abroad, and for implementing necessary adjustments to maintain full employment.

Finally, the large welfare state is not solely a machine for redistribution of wealth, but rather a social arrangement that guarantees basic goods and services to citizens that the private sector fails to deliver with equal ease. Many of these provisions relate to social insurance against loss of health, income or employment, where the terms of insurance are better for the poor than for the rich.

The complementarities between institutions and policies make the Nordic social model a broader societal model. There are many examples. For instance, it would be difficult to maintain full employment in the Nordic countries without a comprehensive union movement that provides wage moderation in central wage negotiations, even when unemployment is low. Full employment, in turn, is important for central union leaders to obtain wage moderation without too much resistance among their members. Similarly, full employment makes the burden of the welfare state lighter for each tax payer, while a generous welfare state may facilitate the structural changes in the economy needed to maintain full employment over time. All this can be viewed as a mutual gift exchange (Moene and Wallerstein, 1993a).

In addition, unions have a much stronger influence on the distribution of wages among workers than on the functional distribution of income between labor and capital (Wallerstein, 1999; Moene and Wallerstein, 1995). In turn, the distribution of wages among workers has a strong influence on welfare spending. The small wage differentials that centralized wage-setting creates provide support for universal welfare state arrangements (Moene and Wallerstein, 2001, 2003a). The generosity of the welfare state supports weak groups in the labor market, which compresses the wage distribution even further. Together the two sides can generate a cumulative process that adds up to a sizeable equality magnifier (or denoted ‘equality multiplier’ in Barth and Moene, 2009).

The Nordic model is also characterized by high female labor force participation. Again, there are mutual dependences between the labor market and the welfare state. As the woman joined her husband in the labor force, households naturally demanded more public care for children and the elderly. The gradual expansion of the welfare state made it easier for even more women to enter the workforce, which in turn led to higher support for welfare spending and to stronger economic growth.

These are all examples of how policies, institutions, and behaviors fit together and strengthen one another. One can argue that they constitute a form of institutional equilibrium - or just a society model - where social equality and worker security persist. Yet many observers wonder whether the institutional equilibrium supports lasting social and economic achievements. One reason may simply be that they misunderstand what the Nordic model entails, and who constitute the winners and losers.

# Conflicting views

The most conventional view of the Nordic model is derived from the classic conflict between labor and capital. It assumes that the model is built on a basic compromise between the interests of employers and employees, in which a strong labor movement has pressed employers to make political and economic concessions – historically to stop ideological contagion from the Soviet Union. This capital-against-labor view implies that a stronger labor movement stabilizes the system and its achievements, while stronger capital owners undermine the system.

Others would claim that the Nordic model is an exception from the rule, and that it is only feasible and stable in small, homogeneous societies with an extraordinary commitment to equality. This view emphasizes that the Nordic countries historically were homogeneous with respect to religion, language, and ethnicity. In addition, the countries had a rather egalitarian distribution of land. Social homogeneity and the small differences in initial wealth led to more egalitarian preferences in the population than elsewhere. If true, this view of Nordic exceptionalism implies that the stability of the system and its achievement depend on the viability of the egalitarian preferences in the population, while more self-interest and less solidarity would undermine the system.

Yet another view, often held by representatives of the political right, claims that the Nordic model is based on too much equality, too much worker security, and too much regulation for the good of the economy. The model lacks the dynamics of entrepreneurial creativity – the essence of capitalism, they would claim. This capitalism-without-entrepreneurs view implies that the stability of the system and its achievements requires regulated markets. Less market regulation and more globalization would undermine the model.

Finally, there is a view often held by representatives on the political left, claiming that union-leaders misrepresent the interests of their rank and file by accepting wage moderation in central wage negotiations and by imposing restrictions on industrial actions in local wage negotiations. This unwarranted-class-collaboration view implies that the stability of pro-labor outcomes requires class struggle and not cooperation between labor and capital. More class collaboration would undermine the best features of the Nordic model.

Although there may be some truth in all of these views, none of them capture the essence of the Nordic model as I see it. While Nordic exceptionalism underestimates the conflicts inherent in the system, labor against capital gets them wrong. The arguments behind both capitalism-without-entrepreneurs and unwarranted class collaboration fail to see that the social arrangement of the Nordic countries may well benefit both labor and capital.

In fact, implicit worker-employer coalitions have led to both wage compression and improved performance over the last 50 years, especially in Norway and Sweden. Initially, the main concern of the two parties was not equality, but rather macroeconomic efficiency by way of encouraging structural change through investment in good modern jobs. ‘Equal pay for equal work’ achieved exactly that. This was the first step towards the solidaristic wage bargaining that became institutionalized in the 1950s.

# Evolution, not intelligent design

The coordinated wage bargaining of Sweden and Norway constitutes the most dramatic instance of union-sponsored wage equalization in the world. In both countries, an ambitiously egalitarian wage policy was adopted by the central blue-collar confederation in the early 1950s and pursued steadily for three decades. ‘Solidaristic bargaining,’ as the policy was named, called for the equalization of workers’ pretax income by eliminating or reducing the wage differentials that existed between plants within the same industry, between industries, between regions and ultimately between occupations (Moene and Wallerstein, 1995, 1997).

While solidaristic bargaining was part of a wider social democratic package that included substantial increases in the generosity of welfare programs, the most important support for solidaristic bargaining came from those who benefited directly. In principle the same egalitarian goals could have been achieved with steeply progressive taxes and targeted transfer payments instead of wage equalization. In practice, however, political support for an analogous and equivalent redistribution through taxes and transfers would have been more difficult to obtain.

The significance of solidaristic bargaining extends beyond the labor markets of the Nordic countries. The main beneficiaries of solidaristic bargaining are to be found in the tail ends of the income distribution curve, among low-paid workers and high-paid capitalist employers; the losers are high-skilled middle-class workers, those in the middle of the curve. Solidaristic bargaining was initially supported by important actors opposed to redistribution. The efficient and innovative enterprises gained from wage-setting with small wage differentials. A compressed earnings distribution was supported by a coalition between numerous workers *and* influential capital owners. Such concurrent interests, typically categorized as *alliances of ends against the middle*, may explain the viability of the Nordic model and why it is associated with high economic growth (Moene and Wallerstein, 1995, 1997, 2003b).

## Equality stimulates innovation

Despite the claims made by supporters of the capitalism-without-entrepreneurs view of the Nordic model, wage compression does in fact stimulate innovation, as firms with advanced new technologies do not have to pay excessive wage premiums. While wage inequality operates as though high-productivity firms were taxed and low-productivity firms were subsidized as wages adjust to local conditions, wage compression works in the opposite way: It is as though high-productivity firms were subsidized and low-productivity firms were taxed. As a result, wage equality implies that inefficient firms close down earlier as newer and more productive firms enter – contributing to the process of structural change that Joseph Schumpeter called ‘*the process of creative destruction.*’

The Nordic experience reminds us of the importance of implementation and procedures for policy outcomes. In the Nordic countries, and maybe more generally, interests may play out very differently

in the labor market than in parliamentary politics. This is important, as coalition structures and economic interests in the economic base obviously affect policies chosen in its superstructure. What made the Nordic countries distinct is precisely the strength of the coalitions of ends-against-the-middle in the labor market, which compressed the distribution of wages among workers.

The wages of high-skilled middle-class workers were held back in the name of solidarity, raising profits and investments, which in turn made it possible to increase the wages of the low-paid workers without creating unemployment.

The small wage differentials that emerged led again to a change in the pattern of political competition in the electoral arena. As economic differences within the electorate became smaller, there were fewer divergent interests in the determination of welfare spending. Moreover, wage compression for a given total income implied that the majority of workers received higher pay and thus demanded higher social insurance, simply because insurance against income losses is a normal 'good,' the demand for which rises with income (Moene and Wallerstein, 2001, 2003a).

## Globalization

Recently, the Nordic model has been in the headlines of the globalization debate. Some observers have foretold the death of Nordic egalitarianism as trade becomes freer, capital mobility higher, and migration flows stronger.

Yet, freer trade is not a threat to the Nordic model, since the small open economies of Scandinavia have long been used to the discipline of international competition (Finland has quite a different trade history). All in all, Nordic countries' freer trade has in fact helped sustain institutions necessary for wage coordination. In addition, freer trade has tended to increase, not decrease, political support for welfare spending, to protect voters against fluctuations in the world economy (Barth, Moene and Wallerstein, 2003).

Higher capital mobility is basically not an issue for concern. Great mobility of capital implies that capital owners must at least earn international returns on their investments to remain in a country. It does not imply that wages have to be distributed more unequally, or that we have to dismantle the welfare state. As long as profits are high enough, capital mobility provides employers with no credible threat.

It is true that greater labor mobility might be a threat to the Nordic model if workers became sufficiently mobile. If workers were hyper-mobile, egalitarian countries would attract many more low-skilled workers and lose many more high-skilled workers. In the European Union, however, there have been no formal restrictions on labor migration since 1993, and yet the level of migration has been low in spite of large wage differentials. Despite the absence of any formal restrictions on migration, an unskilled worker in Portugal would earn four times his wage if he moved to Denmark.

In summary, the Nordic model consists of what should be characterized as *free-trade institutions*. The system of wage determination is one free-trade pillar, even though it initially was established for

other reasons as well. In any case, in the Nordic model wages are taken out of competition and moved into collective decision-making, where unions and employers in export-oriented sectors set the pace for the average wage increase for the entire economy. One important goal is to remain competitive in the global economy.

Similarly, the welfare state represents another free-trade pillar, even though it too was gradually expanded for other reasons. The welfare state is an effective way to share the costs of an open economy, where certain sectors are more exposed to international competition than others. The welfare state provides a *collectively-paid insurance* against the risks associated with fluctuations in international markets. That means that the burden of remaining competitive is not laid on any one segment of the economy. Sharing the costs makes sense, since the entire economy is dependent on the performance of the traded-goods industries in the world market. In addition, the welfare state socializes human capital investments in education and health that also effect performance in global markets.

## Victim of its own success?

External threats to Nordic equality are much more widely discussed than internal threats to equality. Yet, there remains a question whether the Nordic model can withstand the growth in the middle class that an egalitarian educational policy implies. More generally, we might ask whether the social and economic results of the Nordic model will really reproduce the conditions for its continuation.

Together with the now late Michael Wallerstein I have argued repeatedly that the Nordic model might become a victim of its own success: The high social mobility that the model so successfully has achieved can create the conditions for its gradual decline. The Nordic model traditionally holds back the middle class in the name of solidarity with low income groups, via the impact of wage moderation on profits and investments. To continue this pattern of income redistribution from the middle to both ends of the income distribution curve becomes more of a challenge as the middle class grows to constitute the majority in society.

However, it is encouraging to observe that the Nordic model is more in fashion again as a source of inspiration to other countries. In China, the government has ambitions of building what it calls a 'harmonious society' with an emphasis on redistribution, welfare, and social security. Leaders in Latin America and in South Africa refer explicitly to Scandinavia as a role model for equitable growth. As encapsulated in the *International Herald Tribune*, September 17, 2005: "European leaders want to know how Sweden and its Nordic neighbors, so heavily laden with cradle-to-grave welfare systems, float high above the struggling economies of much of the rest of the Continent."

The recent financial crisis has raised praise for the model at home too. The Nordic countries, except Iceland, seem to have done relatively well during the crisis, at least compared to most other countries. Financial stress and economic fears also concern the middle class, and the social insurance

that the Nordic model provides has gained in popularity. Perhaps failures elsewhere can prolong the egalitarian success of the Nordic model.

## Summary

The Nordic model is seen not as a concession by employers to workers, but rather as a political and economic system that benefits all. The rise of the model is best understood as a cumulative evolutionary process. The model is not the result of intelligent design, but rather of gradual cumulative reforms and implementations. The special type of equality that the model provides seems to stimulate, rather than hamper, innovation and structural change. The model is not directly threatened by globalization such as more free trade and higher capital mobility. However, the model may yet become a victim of its own success. It could produce results that undermine the reciprocity of mutual insurance and solidarity. The article also contains a list of some research papers where these views are further elaborated.

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