European Social Models from Crisis to Crisis

Employment and Inequality in the Era of Monetary Integration

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The Nordic Social Models in Turbulent Times

Consolidation and Flexible Adaptation

Jon Erik Dølvik, Jørgen Goul Andersen, and Juhana Vartiainen

The small, open economies of the four Nordic countries discussed in this book—Denmark, Finland, Norway and Sweden—were hard hit by the global crisis in 2008, only 15 years after they began recovering from severe, self-inflicted crises. Renowned for their pooling of risks through extensive social insurance, public services, corporatist coordination, and low inequality, by 1990 the Nordic countries were struggling with crises widely seen to show that their social democratic systems had become sclerotic and incapable of meeting the challenges of globalization. According to the Swedish Prime Minister Carl Bildt: "The time for the Nordic model has passed... It created societies that were too monopolized, too expensive and didn't give people the freedom of choice that they wanted; societies that lacked flexibility and dynamism" (*International Herald Tribune*, February 24, 1992).

Still, the Nordic countries managed to work themselves out of the abyss without dismantling their social models during the 1990s, and in the early 2000s they were rising to top international rankings of economic efficiency, employment, and equality. Hailed as role models for the EU, even the center-right embraced the Nordic model. And when the Nordic countries seemed to ride out the financial crisis more smoothly than many others, *The Economist* (February 1, 2013) declared them the new "supermodels."[1] With solid public finances, the Nordic countries responded to the 2009 shock with

[1] In explaining the favorable Nordic performance, *The Economist* focused on tax relief and market reforms, while ignoring the strong Nordic pillar of unionism and collective bargaining (Freeman 2013).

countercyclical fiscal policies. Sweden and Norway could also invoke monetary policy tools and benefited from temporary depreciations of their Kronas. After swift rebounds in 2010–11, the second dip in the Eurozone prolonged the recession in 2012–13; unemployment remained in the range of 7–8 percent—3.5 in Norway—but from Fall 2013 the economies were slowly recovering, except in Finland. Although the Nordic models have now weathered an international crisis more severe than the one they survived in the 1990s, unemployment is markedly higher than before, inequalities have increased, and political pressures for change have grown.

In this chapter we argue that there was no magic bullet behind the Nordic recovery in the 1990s. Apart from initial currency depreciations, Nordic policies were in many respects in line with the contemporary mainstream. The crux of the Nordic models, we argue, has been the actors' capacity for coordinated policy adjustment, which—facilitated by relatively balanced power relations and trust—has enabled coherence and complementarity between policies in key areas. The Nordic models cannot be conceived of as a fixed set of institutions and policies. In small, open economies, adjustment to changing circumstances has always been required, and solutions have been inspired by foreign ideas but adapted to domestic institutional contexts. Still, faced with increasingly turbulent international environments, ageing, and more diverse populations, it remains to be seen whether their political capacity for flexible adjustment (Katzenstein 1985) is sufficiently intact to preserve the key tenets of the models— high employment levels, low inequality, and encompassing labor and welfare regimes.

We proceed in Section 8.1 by taking a snapshot of the Nordic models up to 1990. Section 8.2 reviews the main changes in the Nordic models and labor market outcomes for the period 1990–2008. Section 8.3 analyzes the impact of the Great Recession and the social models' role in cushioning it. Section 8.4 concludes, arguing that the Nordic models and the way they were adjusted after the crises in the 1980–90s contributed importantly to their ability to weather the recent crisis.

8.1 The Nordic Models at the Threshold of the 1990s

Although the Nordic countries are often seen as a homogeneous bloc, they have followed different paths of evolution (Mjøset 1986; Mjøset 2011). The small Nordic economies are all highly reliant on international trade, but their export structures have differed significantly. Nordic variety is also found in politics. While Denmark has a tradition of minority coalition governments and compromises across the left–right divide,[2] Sweden was for long periods of the twentieth century distinguished by its hegemonic social democratic party and more polarized class politics. Finland, by contrast, was marked by a predominant center party, a relatively small social democratic party, and highly variable coalitions. In Norway, the Labor Party long had a dominant role, but recent decades have seen shifting social democratic-led and center-right coalitions. When entering the 1990s, Denmark, Finland, and Norway were all governed by conservative-led coalitions, followed by Sweden in 1991, but in the early–mid-1990s the social democrats returned in office in all four countries.

After Denmark had been the only Nordic member of the EC since 1972, in 1989 the Nordic EFTA-countries—Finland, Sweden, Norway (and Iceland)—initiated a cautious adjustment to the EC along the EEA-track (European Economic Area). The economic meltdown in Sweden in 1990 spurred a swift application for EC membership, soon followed by Finland and Norway. The fall of the Berlin Wall, and the renewed pace of European integration, implied profound changes in the external conditions for domestic policies. Finland and Sweden became members of the EU in 1995. Finland also joined the Eurozone from day one. Norway entered the single market through the EEA agreement in 1994 (excepting agriculture and fisheries) and later joined Schengen and several other EU schemes. All four countries thus became economically incorporated into the single market from 1994, so that, except for monetary policies, they have largely faced the same opportunities and constraints.

By 1990, the social democratic models of the Nordic countries (Esping-Andersen 1990) were distinguished by their universal welfare states and encompassing peak associations overseeing multilevel bargaining systems with strong company tiers. Labor law provided individual employment protection and representation at company levels, alongside forceful dispute settlement mechanisms and strict peace duties between bargaining rounds. The welfare state granted universal rights to income security and education, typically financed by taxation. Extensive public services and active labor market policies (ALMPs) contributed to high participation rates for both sexes. Around 20 percent of the labor force had higher education—more than a doubling since 1970 (Dolton et al. 2009). Denmark stood out with an apprentice-based vocational training system organized together with the social partners (Nelson 2012), while the others run school-based systems and Norway a mixed system (Høst 2012).

[2] The involved actors have also enjoyed an informal veto right afterwards (Pedersen 2011).

Traditionally, the interdependencies between economic policies, collective bargaining, and welfare policies, granted the social partners a central role in macroeconomic coordination, anchored—except in Sweden—in a legacy of tripartite incomes policies. According to the Swedish Rehn–Meidner model, the interaction between product market competition, solidaristic wage setting, and the income security systems was a major driver of restructuring. High wage floors and uniform pay increases forced unprofitable firms out of business and reallocated labor into the most productive firms and sectors (Hibbs and Locking 2000), while income security and mobility-enhancing labor market policies assured unions of the benefits of productivity-oriented cooperation at the company level—a prime example of "politics with markets."[3] The welfare state was thus seen as a productive arrangement. Mobilization of female labor was encouraged by individual taxation and expanding public services for children and the elderly in particular—facilitating transition to the post-industrial society.

The viability of the Nordic social model was called into question by the acute economic crisis into which Finland, Norway, and Sweden fell around 1990—as Denmark had done 15 years earlier.[4] However, the causes lay elsewhere. Faced with the credit market deregulation of the 1980s and the absence of a nominal anchor, a common feature was the breakdown of coordination between macroeconomic policies and collective bargaining alongside an inability to restrain the credit-induced boom with restrictive fiscal policy. With demand-driven wage-price spirals, devaluations, and eventually huge bank and housing bubbles, the pace-setting role of the export sectors in wage-setting came under pressure from inter-union struggles over relative wages. Toward the end of the decade, a doomed attempt to implement a strong currency policy aggravated the private debt burden and led to ballooning current account deficits. The resulting hard landings when the bubbles burst were worsened by the European post-unification recession and the crisis of the European Exchange Rate Mechanism (ERM), the predecessor to EMU, within which the Nordic countries were caught up.

As a result, Finland, Sweden, and Norway experienced existential crises in the early 1990s. With sharply falling property prices, bank collapses,

[3] This was in line with the Schumpeterian idea of creative destruction of capital (Schumpeter 1942).

[4] For Denmark, the "disciplinary" adjustments in economic policy started in the early 1980s, and one may wonder whether Denmark's less responsible economic policies of the 2000s (see section 8.3.2) were due to the fact that these lessons were less fresh in the minds than those of the other Nordic countries. After the oil crisis in 1972, Denmark continued to expand public services, struggling with increasing deficits in budgets and current accounts. After the pegging of the Krona to the DM (1983), it took nearly a decade of export-led growth and constrained domestic demand before a solid balance of payment surplus was achieved (Goul Andersen 1997). Unemployment peaked in 1993, but current accounts had turned into a permanent surplus by 1990, and, in spite of cost containment, welfare state institutions were left almost untouched (Goul Andersen 2000).

skyrocketing interest rates, volatile currencies, and falls in production comparable to the 1930s, gross unemployment surpassed 20 percent in Finland, 10 percent in Sweden, and 9 percent in Norway. Denmark, slowly recovering from previous failures, also saw a new surge of unemployment in 1990–93. No wonder the Nordic models were doomed by many external observers, and drastic measures were proposed to bring the situation under control.

8.2 Changes in the Nordic Social Models 1990–2008

8.2.1 *Overview*

The crisis of the 1980–90s prompted significant changes in the Nordic models, most so in their systems of macroeconomic policies and wage setting. Alongside currency depreciations (Denmark excepted), central banks were made independent[5] and charged with ensuring price stability, while forceful budgetary consolidations eventually morphed into rule-based fiscal policies. Product markets were deregulated as part of adjusting to the EU single market. Sweden and Finland also tightened some social benefits and Sweden liberalized temporary work. As elsewhere, labor market, social, and tax policies were geared toward increasing labor supply. Marginal tax rates were lowered and tax bases broadened. Alongside greater emphasis on activation, conditionality of benefits, education, and arrangements to reconcile work and family life, pension reforms aimed at strengthening welfare state sustainability. These measures eventually contributed to a strong recovery. By the turn of the millennium, both budgets and current accounts were in surplus. This remained the case until the financial crisis in 2008.

While all the Nordic countries except Norway were governed by center-right coalitions in the early 1990s, elections in the wake of the crisis initiated a new period of successive social democratic-led governments. The employer confederations and conservative parties (most pronouncedly in Sweden and Finland) first sought to respond to the crisis by rolling back the welfare state and deregulating labor markets, but the social democratic comeback and the recovery facilitated a more cautious approach. Altogether, the reforms of the 1990s contributed to a consolidation rather than a dismantling of the social models.

The adjustments emerged from contested political processes and compromises conditioned by earlier institutional configurations. With major parts of the electorates and the unions seeing an interest in protecting their stakes in the existing social models, the forces calling for more radical breaks with the past were unable to muster sufficient political support. Underpinned by institutionalized balances of power in working life, this gave rise to coalition-building and patterns of change that were oriented toward maintaining roughly unchanged social outcomes. This enabled the social democrats to remain in power well into the 2000s.

[5] The Danish Central Bank, established in 1818 after sovereign default, was always autonomous from the government.

The main conservative parties then drew the conclusion that an "anti-Nordic" strategy was bound to fail politically, so that the road to power went via acceptance and incremental reform of the Nordic models. In a context of prosperity and pledges to expand welfare and reduce taxes, this strategy shift was successful, and their electoral victories in the 2000s were built on a political realignment of the center-right around and not against the social democratic model.

The subsequent sections review the main changes in the Nordic models from 1990 to the 2008 financial crisis. The emphasis is on how the four countries worked themselves out of their crisis in the early 1990s, followed by brief references to changes undertaken by the center-right governments during the boom in the 2000s.

8.2.2 *Adjustments in the Regimes of Macroeconomic Policies*

While Denmark had gone through crisis and austerity in the 1980s, the crises in Finland, Sweden, and Norway in the early 1990s sparked sweeping changes in economic policies. In the first place, the financial systems were shored up by the state, guaranteeing deposits and creditors, letting shareholders incur losses, nationalizing collapsed banks, and imposing stricter regulations and supervision. Central banks became independent guardians of price stability. A short-lived attempt to peg the currencies to ECU (like in Denmark) was given up amid the ERM turmoil. This led to currency depreciations of 20 percent in Sweden (Flodén 2012: 13), almost 40 percent in Finland (Vartiainen 2011a: 74), and 5–6 percent in Norway (NOU 2003: 13). Combined with industrial transformation, productivity growth, and falling unit costs, the depreciations spurred strong export growth which from 1994 served as an engine for recovery. While Sweden and eventually Norway maintained inflation-targeted monetary regimes with floating currencies, Finland joined the Euro in 1999, and Denmark upheld its stable rate against the Euro.

In Finland and Sweden the slump opened up huge public deficits exceeding 10 percent of GDP. While Norway could rely on rising oil revenues, Finland and Sweden enacted substantial budget cuts and tax increases. In the immediate aftermath of the crisis, Swedish fiscal policy was expansive; it was when the recovery had first taken hold in 1994–95 that the main fiscal consolidation was initiated, in total amounting to 11 percent of Swedish GDP in 1995–97

(Flodén 2012: 13–14).[6] The Finnish recession was even deeper and consolidation started earlier, but by 1998 the huge deficits in Sweden and Finland were turned into surpluses. In Sweden this period of severe austerity was followed by establishment of a strict, rule-based fiscal policy regime (Erixon 2011).[7] Denmark had gone through harsh fiscal disciplining in the 1980s, enabling it to counter the European recession in 1993 with moderately expansionary fiscal policies and easing of credit policies. In contrast to the presently crisis-ridden Eurozone countries, Sweden and Finland could combine tough fiscal consolidation with solid growth, largely due to the initial currency depreciations which kicked off vigorous export-driven recoveries. In parallel, revenue neutral tax reforms enabled steady rises in public incomes and domestic demand when exports recovered from 1994–5. Entering office with strong public finances, the center-right coalitions presiding over the boom in Sweden and Finland in the 2000s used the room for maneuver to grant significant tax reliefs and curb budget growth. In Denmark a more pro-cyclical fiscal policy and credit liberalization in the 2000s fueled a subsequent bank and housing bubble.

8.2.3 *Changes in Wage Setting and Labor Market Regulation*

During the overheating of the 1980s, centralized wage coordination broke down, which contributed to wage-price spirals and inter-union rivalry (Dølvik and Vartiainen 2002). Denmark and Norway had already gone through a period of turbulence and government intervention when the Swedish employers' association SAF in 1990 declared its withdrawal from centralized pay-bargaining and called for market-based wage-setting—soon echoed by Finnish employers. These calls were not heeded. Influenced by the crisis and prodded by the state—in Sweden through the Rehnberg Commission (Kjellberg 1998)—key labor-market actors agreed to restore wage moderation by re-establishing coordination and the pace-setting role of the export industries. In Finland and Norway this was achieved through traditional tripartite incomes policies. The 1995 pact in Finland also aimed to compensate for the loss of the exchange rate mechanism in EMU with increased aggregate wage flexibility (Dølvik 2004). In Denmark[8] and Sweden, manufacturing unions

[6] The Swedish fiscal consolidation was larger than what had occurred in any other OECD country from the early 1970s up to the 2008–11 period (Erixon 2011: 273).

[7] A rule-based fiscal regime was also established in Norway in 2001, aimed to prevent excessive use of revenues from the oil-based pension fund.

[8] A tripartite settlement about responsible wage setting was previously signed in Denmark in 1987, while new legislation linked wage increases in the public sector and most social transfers to private sector wage growth.

and employers regrouped in order to coordinate their wage-setting and re-establish the export industry's wage leadership, at the same time allowing more leeway for local pay and working time determination (Scheuer 1998; Due et al. 1994; Elvander 2002a). Norway eventually moved in the same direction, while more decentralized bargaining first became an issue in Finland in 2007. In Sweden, the path-breaking 1997 Industrial Agreement encompassing all federations in manufacturing also entailed a strict mediation procedure, which was later complemented by a National Mediator covering the other sectors (Elvander 2002b).

These changes restored wage coordination led by the export industries, now mostly based on pattern-bargaining at the sectoral level, leaving more space for local pay-setting (Vartiainen 2011b). Such wage discipline was facilitated by rule-based macro-policies. Interest rates set by the central banks disciplined wage setting in Sweden and Norway, whereas Finnish and Danish negotiators had to comply with Eurozone monetary conditions. Hence, after the crisis of the 1990s, Nordic industrial relations showed surprising resilience and adjustment capacity, evolving into a direction of *both* more efficient wage coordination *and* more micro-flexibility.

The Nordic regimes of employment regulation remained largely unchanged in the 1990s, except that Sweden liberalized temporary hiring (see Figure 11.5). Norway went in the opposite direction, whereas Denmark always had very liberal employment protection. In 2005, the Norwegian center-right government also liberalized temporary hiring, but this was immediately repealed by the incoming Red–Green government. The Swedish center-right government further liberalized temporary work in 2007, prompting reactions from the European Commission that it contravened the EU Directive on temporary work. By 2000, all four countries had also liberalized the market for temporary work agencies.

The implementation of EU minimum directives on workers' rights after entrance into the EU single market was mostly uncontroversial, and several directives led to strengthened workers' rights (Ahlberg et al. 2005). The legislative transposition of EU rules, however, sparked concern that juridification would undermine Nordic collective agreements (Madsen and Due 2008). This issue featured in the negotiations over the Maastricht Treaty in Denmark and the Swedish accession agreement (Ahlberg et al. 2005). Still, after repeated conflicts with the European Commission, Denmark had to accept that implementation via agreements was to be flanked by statutory regulation.

The issue resurfaced after the 2004 EU enlargement, which brought a sharp rise in labor mobility from the new member states, especially in Norway where EU migrants accounted for around two-thirds of employment growth from 2004 to 2013. Fueling the boom in the 2000s, this was accompanied by increased low-wage competition, and—as epitomized by the Laval and Viking cases—new clashes with the law-based EU regime (Dølvik et al. 2014). Finland and Norway (in some industries) relied on statutory extension and state enforcement of minimum pay and core standards in collective agreements in line with the Posting Directive (EC 71/1996).[9] Denmark and Sweden, by contrast, maintained their traditional regimes, wherein unions were entitled to enter agreements with foreign companies, if necessary by means of industrial action. In the Laval case, where the Swedish construction union had done so against a Latvian company, the ECJ deemed the actions in breach of the Posting Directive since the suggested agreement had no clear minimum pay provisions and entailed conditions outside the directive (Malmberg 2010). Deeming the Swedish and Danish way of implementing the directive incompatible with the EU free-movement regime, the ECJ ruled that union action underpinning bargaining demands beyond the legal minimum was unlawful in cross-border contexts.

In response, Denmark and Sweden amended their legal basis by invoking a special clause of the directive (paragraph 3.8). While the Danes signed a tripartite agreement with minimal changes in national practices, the new Swedish rules only allowed union action against foreign firms to obtain minimum pay rates defined in nationwide agreements and legal minimum standards. Hence, foreign employers obtained stronger protection against industrial action than domestic ones (Evju 2010).[10] In response, Swedish unions started negotiating minimum rates in agreements which had previously left pay-setting to company-bargaining—an ironic example of reduced flexibility driven by EU-law. Employer voices in Sweden, Norway, and lately Finland, have accordingly called for a statutory minimum wage—formerly a taboo—spurring union demands for extension of collective agreements. The pressures from European law and low-wage competition have thus given impetus to more state regulation, controversy among the social partners, and Euro-skepticism in the trade unions.[11]

[9] A 2013 ruling of the Norwegian Supreme Court in favor of the unions in a related case concerning extension of collective agreement terms (including compensation for travel, meals, and lodging) to posted workers in shipyards has brought a row with the EFTA-court, and (at the time of writing) a case regarding Finnish rules to ensure equal conditions for foreign temp workers by 2014 is pending in the ECJ.

[10] In 2013, the ILO Committee on Freedom of Association and the European Committee of Social Rights under the Council of Europe deemed the new Swedish legislation in breach of the right to freedom of association and negotiations laid down both in ILO convention 87 and the European Charter of Human Rights. The social democrats have thus suggested that they will amend the law if they return in office after the September 2014 election.

[11] Contestation of the EU regime has also been heightened by recent ECJ decisions implying that EU labor migrants, if conditions are fulfilled, are entitled to unemployment benefits in the host country from day one.

UNION DENSITY AND COLLECTIVE BARGAINING COVERAGE

Nordic regulation by collective agreements depends on union density and presence in the workplace (Stokke et al. 2013). Supported by the Ghent systems of unemployment insurance, by 1990 union density was exceptionally high (Kjellberg 1992). With above 80 percent in Sweden, and Denmark and Finland close behind, the outlier was Norway with 57 percent and no Ghent system.

After a hike in density in Finland and Sweden during the slump in the 1990s, a downward trend became clear from the mid-1990s, in particular among the young (Kjellberg 2010; Nergaard 2010). Besides structural change, the role of unemployment funds as vehicles for unionization was weakened by introduction of independent funds (Böckerman and Uusitalo 2006; Kjellberg 2010; Due et al. 2010). This happened in Finland in the 1990s. In Denmark the center-right government in 2001 allowed free competition among unemployment funds, including funds without proper union links. In Sweden the center-right government in 2007 increased fees and abolished tax deduction for membership in unemployment funds and unions,[12] soon after also differentiating insurance fees according to unemployment risk. Besides causing a dramatic fall in fund membership in Sweden,[13] union density dropped from 77 percent in 2006 to 68 in 2008, mostly among low-wage unions in private services (Kjellberg 2009). A similar decline was seen in Finland from 1995. In Denmark the blue-collar LO-unions lost more than one-quarter of their membership from 1995–2010, whereas "alternative" unions (providing judicial services but no collective bargaining) grew (Due et al. 2010). By contrast, the organization rates among employers increased or remained stable.

As shown in Table 8.1, unionization fell substantially in all four countries from the peak in the 1990s to 2010, especially in private sector and among low-skilled workers. Parts of the decline can be ascribed to changes in the industrial and occupational structure, as indicated by the decrease in Norway. Still, in comparative perspective, the Nordic level of unionization has remained exceptionally high. The share of private-sector employees with a union presence at the workplace varied in 2008 from 58 percent in Norway and 67 in Denmark to 86 percent in Sweden (Nergaard and Stokke 2010), while union density in the private sector ranged from around 40 percent in Norway to 65 percent in Denmark and Sweden (Nergaard

[12] In Denmark deductions for union and unemployment fees were cut through successive tax reforms from the 1980s till 2009.

[13] As fund membership fell by half a million in two years, 29 percent of employees (1.3 million) stood without insurance in 2009, compared to 17 percent in 2006, and around 50 percent of the unemployed were uninsured in 2009. Membership started growing again during the crisis, but two-thirds of the unemployed were still uninsured by 2012 (*Dagens Nyheter*, December 22, 2012).

Table 8.1 Total trade union density in Nordic countries 1990–2010 (percent)

	Finland	Denmark*	Norway	Sweden
1990	73	75	57	80
1995	80	73	56	83
2000	75	72	53	79
2005	72	72	53	77
2008	68	68	51	68
2010	70	67	51	68
Change 1995–2010	**–10**	**–6**	**–5**	**–15**

* Including "alternative" Danish unions organizing 10 percent 2010.
Source: Nergaard 2013

2013). Collective agreement coverage in private sector varied from around 50 percent in Norway to almost 85 percent in Sweden and Finland (Andersen et al. 2014). Eventually union density and collective bargaining coverage stabilized during the Euro-crisis, but membership in blue-collar unions continued to decline while increased use of subcontracted, migrant labor put pressure on the bargaining system.

8.2.4 *Boosting Labor and Skill Supply: Adjusting Social Policy, Taxes, and Skill Formation*

Apart from cost containment, the Nordic welfare states emerged from the crisis of the 1980s and 1990s with little change. Changes in institutions were few and incremental, and the principle of universalism was largely maintained. In many areas it was strengthened, in others somewhat restricted—mostly in crisis-ridden Sweden and Finland.[14] A common denominator was to "activate" the welfare and tax system in order to increase labor supply and reduce welfare dependence, not least because of the upcoming challenge of ageing. Alongside experiments with a "mixed economy of welfare," the last 10–15 years before the Great Recession witnessed a second "golden age" of the welfare state, with expansion of social services, higher education, and family- and child-oriented social investments.

In essence the reform efforts under social democratic rule from the mid-1990s were aimed to preserve as much as possible "as it was" in the Nordic welfare states. This was not much changed under the center-right governments returning in office in the booming 2000s, but they cut taxes, tightened certain

[14] In Denmark universalism was strengthened by flat-rate child and student benefits, free home help services, and wage indexation of social transfer payments. Parental leave schemes were extended in all countries, whereas home-help services became more targeted in Sweden and, for example, basic sickness allowances were closed (but later restored) in Finland (Goul Andersen 2000; Timonen 2003; Kangas and Saloniemi 2013).

benefits, and challenged some elements of the Nordic models—such as the Ghent systems of unemployment benefits. The Nordic countries nevertheless entered the Great Recession with substantial budget surpluses.

THE TRAJECTORY OF WELFARE STATE CONSOLIDATION AND ACTIVATION AFTER THE 1990s CRISIS

Apart from the range of cost-containing measures enacted to close the gap in public budgets after the crises in Sweden and Finland—including more reliance on user fees, private providers, stricter contribution requirements in some fields, bracket creep, and waiting days in various benefit schemes, (e.g., sick pay)—the Nordic trajectory of welfare state consolidation was marked by strengthened emphasis on skill formation and activating social policies, including reforms of the pension and tax systems. In line with the "social investment approach" (Morel et al. 2012), the main aim was to stimulate and upgrade labor supply, thereby increasing revenues and reducing expenditures.

- ***Investing in education and reforming vocational training***: During and after the slump, all four countries expanded education. From 1990 to 2005 the population-share (25–64) that had completed tertiary education rose from 15.7 to 33.0 percent in Norway and similarly in the other countries (Dolton et al. 2009: 3). Secondary education was made available to the large majority of youth—and a statutory right in Norway—while efforts were made to improve and expand vocational training. In Denmark, where the apprentice-based systems attracted high shares of each cohort, programs were in the 1990s broadened to enable more flexibility, and simplify completion (Nelson 2012: 197). Similar adjustments were made in the school-based Finnish and Swedish systems, and the mixed Norwegian one. Denmark in the 1990s invested significantly in lifelong training and adult education in cooperation with the social partners. Altogether, these efforts reflected the emphasis laid on adjustment and upgrading of the labor-force skill-structure in order to boost competitiveness and labor market inclusion in the 1990s. Nonetheless, in the 2000s poor completion and high drop-out rates from secondary and vocational education in particular indicated that new patterns of marginalization were emerging, especially among male and immigrant youth. While Finland was among the best in the OECD PISA-studies, the others showed deteriorating results, especially Sweden.
- ***Pension reforms***: Even though demographic prospects were comparatively benign,[15] the Nordic countries were proactive in reforming

[15] Fertility rates remained high by European standards, stimulated by adequate child care, benefits, and parental leave, and net migration was positive.

pension systems. By 1994/1998, Sweden had already replaced its two-tier people's pension with a partly funded notional defined contribution scheme with a minimum guarantee (Lindquist and Wadensjö 2011). The retirement age at 65 was retained and the contribution rate was fixed at 18.5 percent, with pension benefits calculated according to age-cohort life expectancy and economic growth. Norway and Finland followed a roughly similar course—Norway with flexible retirement from the age of 62 (Kangas and Luna 2011; West Pedersen 2010). The Danish reform was perhaps the most radical. From 1991, fully funded "labor market pensions" were introduced via collective agreements for nearly all workers not already covered. By 2010, contributions reached a minimum of 12 percent. The flat-rate people's pension was maintained in a substantially more targeted version (Goul Andersen 2011). Pension age was indexed to life expectancy at 60. Taking 1995 as base year, this will increase pension age beyond 70 and reduce the pension period by three years, regardless of longevity. The early retirement scheme (efterløn) was modified by 1999 and is de facto phased out by a retirement reform adopted in 2012, which also raised pension age to 67 years from 2022. Despite differences in institutions, in political paths of change (Kangas et al. 2010),[16] and in radicalism, the reforms were basically equivalent. The common principle of "defined contribution" broke away from traditional "decommodification." In Denmark this was compensated for by partly maintaining the people's pension and by a new targeted supplementary pension scheme for the lowest incomes (Goul Andersen 2011),[17] and in the other countries by the guarantee pension. Pension benefits are adjusted to longevity, and defined contribution pensions give incentives to postpone retirement: younger generations must work longer to obtain the same pension. Whether future minima will be equivalent mainly depends on indexation of the guaranteed pension, which is indexed by wages in Denmark, by prices in Sweden, and a mixture of both in Norway and Finland. Altogether, early retirement has generally been abolished, except in Finland, and working age prolonged, by and large suggesting that the pension challenge is solved in all the Nordic countries, with perhaps a formal caveat as to Finland

[16] While the Swedish and Norwegian reforms were adopted through broad cross-party compromises, the Danish labor market pensions were developed through collective bargaining, but prodded by the government (1984). Since pension issues in Finland sit uneasily between the competences of the social partners and the government, change has been slower in spite of slightly less favorable demographic prospects, but in the wake of current crisis the Social Partners have committed to introducing a reform, due to be publicized in Fall 2014, that will raise the expected retirement age by two years up to 2025, as compared with 2010.

[17] The Swedish and Danish pension systems also include preferential housing benefits.

where no political agreement about reform has been struck yet.[18] As social differences in health and longevity persist and even tend to increase, however, new inequalities and care challenges are foreseeable among older workers.

- ***Reforming taxes***: In a series of tax reforms, high and progressive income tax rates were significantly reduced, especially aimed at lowering marginal taxes on wages (Christensen 2013). Except in Denmark, where seven subsequent reforms were enacted under shifting coalitions, the most important reforms were adopted with broad cross-party support in the early 1990s. Most of these reforms followed the principle of revenue neutrality and were financed by broadening the tax base and increasing "green" and other indirect taxes, the regressive effect of which should be kept in mind when considering the modest inequality of household incomes. As a result, marginal tax rates were substantially reduced. After further reforms in the 2000s, by 2013 marginal tax rates on labor in Denmark and Sweden were below the average for the 21 OECD countries in the EU for 7 out of 8 household types. With regard to average taxes, Denmark was below the EU-21 average for all household types, while Sweden and Finland were in most instances just above average, Norway falling in-between (OECD 2014b: 67, 77). Regarding the alleged negative impact of marginal taxes on labor supply, the Nordic countries, in particular Denmark and Sweden, have moved from being "worst cases" to becoming "employment-friendly." Apart from Denmark, the Nordic countries also followed international trends toward a dual tax model where lower taxes on wages were combined with lower flat-rate taxation of capital income. Eventually, the wealth tax was abolished.[19] While the tax reforms in the 1990s had minor distributive effects, the profile of the center-right tax reliefs in the 2000s tended to benefit those in work and those with high incomes and wealth more than others.
- ***Strengthening and broadening the work line***: In response to the high unemployment in the 1990s, the old Nordic "work line" in social policies was revived to bring people from "passive support" to employment or education. As the labor markets improved, recipients became subject to stricter activation duties; integration of immigrants gained priority, and employment efforts were extended to the disabled, the sick, and

[18] Although Nordic pension systems now seem robust, ageing and the fast rising share of the 80+ group will entail growing demands on health services and elderly care, hence affecting the overall sustainability of the public sector (Fløtten et al. 2013).

[19] In Norway the heritage tax was abolished and the wealth tax rate reduced by the Conservative government elected in 2013.

long-term social assistance clients. As the economy recovered, duration of unemployment benefits in Denmark was cut from 8 to 4 years in 1998. Sweden and Finland also saw some retrenchment in benefits after the 1990s' slump, but in general conditionality served as an alternative to cuts in social benefits. In all four countries, the "work line" won support from mainstream parties, employers, and the unions. Whereas generous minima, long duration, and low exit to social assistance boosted the Danish branding of "flexicurity," discouraging results of activation in the early 2000s made the social democratic government in Sweden cut ALMP substantially (Berglund and Esser 2014).

A range of complementary measures were applied to counter the growth in recipients of *disability pension*—in Norway increasing from 236,000 in 1995 to 339,000 in 2008 (NOSOSCO 2009a: 171). The trend in disability rates reversed in the 2000s—first in Denmark, which offered subsidized "flexible" jobs as a last resort (Bingley et al. 2011)—except among young people (mainly due to a growth in psychiatric diagnoses). The preceding rise in *sickness benefit* recipients, especially in Norway and Sweden in the early 1990s (OECD 2010b: 162) triggered different responses: Cuts in replacement rates and unpaid waiting days were introduced under the conservative governments in Sweden and Finland and retained by their successors, while the sick-pay scheme in Norway providing 100 percent replacement (with a fairly high cap) became a sacred cow for the unions, and was in 2001 anchored in a tripartite settlement on "inclusive working life." Since the 1990s, take up of sickness benefits fell in Sweden and Finland, but remained high in Norway and Denmark (OECD 2010b) until the trend recently turned. With variations, the dominant approach has been to prevent marginalization by early intervention, action plans, graded sick pay, and in Denmark by incentives for municipalities to force sick-pay recipients into activation. Also, receivers of *social assistance* became subject to activation and conditionality. Apart from the Danish center-right government's de facto ethnically targeted cuts and strict work requirements in social assistance for immigrants from 2001 (repealed by 2012, see Section 8.2.5) immigrants are well included in the Nordic welfare states (Brochmann and Hagelund 2012). Non-EU immigrants are subject to extensive introduction programs, and during the boom in the 2000s their employment rates increased markedly from relatively low levels. Inspired from abroad, the strengthened "work line" in Denmark and Norway was eventually supported by administrative "one shop" reforms which would prove hard to accomplish when the financial crisis burst.

8.2.5 *A Change in Direction Under Center-Right Rule in the 2000s?*

After the Nordic recovery in the 1990s, center-right coalitions returned in office in the early 2000s.[20] Their prior embrace of the Nordic model meant that continuity was high, but a change of direction was visible in some areas—especially as regards unemployment benefits and the approach toward trade unions. Besides more emphasis on outsourcing and "choice" of municipal services, reduced taxation—not least in the form of tax credits for the employed and various in-work benefits aimed to curb the alleged rise in "outsiders"—were seen in all countries but Norway. Hence, the taxation share of GDP declined markedly in Sweden and Finland for the period 2000–10, and also in Denmark from 2005 (Ferrarini et al. 2012: 16). The pledge to reduce welfare dependence was in Sweden followed by tightening of social benefits—mostly by stealth (frozen caps and replacement)—bringing replacement levels down to the OECD average (Ferrarini et al. 2012). In Denmark negative evaluations of the impact of activation (DØR 2002) spurred a shift toward more disciplinary "workfarist" approaches, and consensus eroded (Goul Andersen and Pedersen 2007). In particular, a series of cuts in social assistance de facto targeted at non-western immigrants[21] were adopted in reform packages with the Danish People's Party, but these were repealed when the center-left eventually came back into office in 2011.

The most significant change undertaken by the center-right governments in Sweden and Denmark in the 2000s was their undermining of the Ghent systems of unemployment insurance, which had underpinned the strength of trade unions in all the Nordic countries but Norway. By the mid-1990s, members financed only 5 percent of fund expenditure in Sweden and Finland and some 20 percent in Denmark (Torp 1999: 65). However, "Social Democratic" Ghent systems can be transformed back into liberal ones by breaking union monopoly, increasing members' contributions, relating contributions to unemployment risk, and making benefits less generous and more conditional. In Denmark, in 2002 the government sought to break union monopoly by allowing all funds to compete for members across union/skill boundaries, also spurring formation of new entrepreneurial funds. In Finland, a similar opportunity was opened in 1992, leading to the expansion of "independent" funds (*Loimaan-kassa*—YTK), and in Sweden by 1998 (*Alfa-kassa*). These reforms in Sweden and Finland aimed only at picking up uninsured individuals

[20] In Denmark and Norway in 2001, Sweden in 2006, and in Finland 2007; in Norway a Red-Green coalition took over in 2005 and remained in office until 2013 when for the first time a Conservative-led coalition including the populist Progressive Party (*Fremskrittspartiet*) took over.

[21] A 2005 "integration package" required ordinary employment for at least 300 hours (later increased to 450 hours) over a two-year period for married recipients to remain eligible for assistance.

and were not designed to break union control (Böckerman and Uusitalo 2006). Regardless, non-union alternatives gained weight in all three countries (Lind 2009; Due et al. 2010: 237). As regards *higher contributions*, incremental changes in Danish tax deduction rules in the 1980–90s and 2009 brought substantial rises in net contributions, amounting to a 50–175 percent cumulative increase by 2009.[22] In Sweden, insurance costs were extremely low until 2007, when contributions tripled and tax deduction was abolished, which, as mentioned earlier, led to more than half a million people exiting the funds. Net contributions in fact equaled those in Denmark, where changes had been incremental and concealed.

Next, contributions could be coupled with sector-specific *unemployment risk*, which in theory should incite unions to wage moderation. Danish governments tried in vain in the 1980s, but the Swedish government managed to do so in 2007–08.[23] Besides the sharp decrease in fund members just at the brink of the financial crisis—implying that half of the unemployed in 2009 were non-members—blue-collar unions suffered big membership losses (see Section 8.2.3). As for *generosity of benefits*, the link to earnings was practically cut in Denmark and Sweden as nearly everybody received the maximum. While the Swedish cap was frozen from 2002, the new government cut replacement to 70 percent after 200 days of unemployment and 65 percent after 300 days. Further, instead of previous monthly wage, replacement was to be calculated on the basis of *annual* income, which especially affected marginal workers. For young people, benefits were reduced even faster and eligibility was narrowed as education no longer qualified. In both countries, unemployment benefits have de facto ended up as a basic security flat-rate scheme (Sjöberg 2011); with net replacement below 60 percent for an "average production worker"—and less for an "average worker." In Sweden, this spurred significant growth in voluntary private insurance via trade unions (Rasmussen 2014: 38). Finally, duration was cut: after 300 days (or twice 300 days) people are transferred to a "job and development guarantee" with a maximum compensation of 65 percent. In Denmark, duration remained unaltered until it was halved after the financial crisis burst (see Section 8.3.5).

8.2.6 *Outcomes: The Labor Market Recovery 1994–2008*

After the 1990s slump—when employment fell as much as 17.5 percent in Finland and 12.5 percent in Sweden—Nordic labor markets recovered strongly from 1994. By 2008 employment had increased almost 25 percent in Finland and Norway, and 16–17 percent in Denmark and Sweden (OECD.stat).

[22] Aggravated by a cap, this applies to deductions for union fees as well.
[23] This shift was eventually reversed in 2014 (see Section 8.3.5).

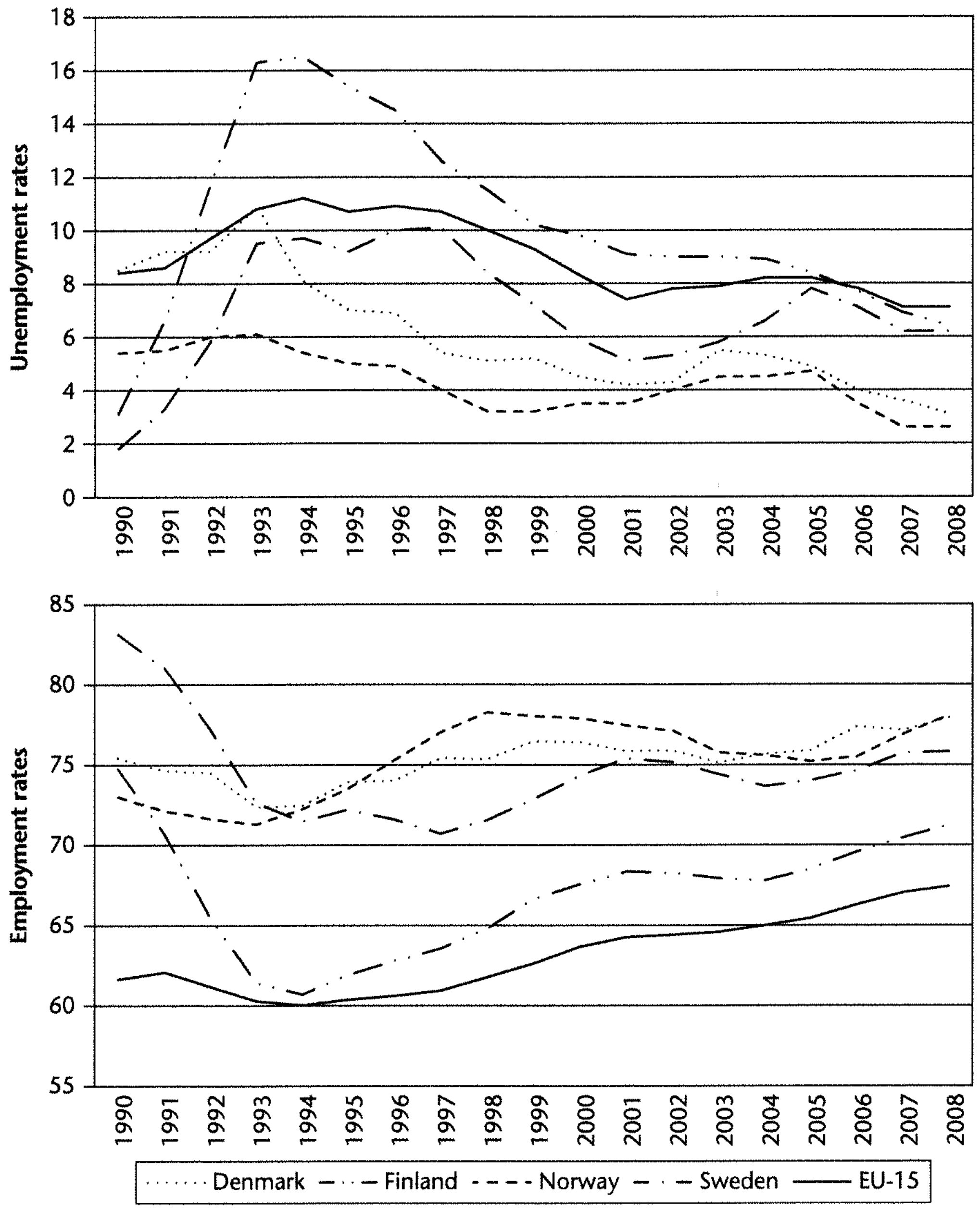

Figure 8.1 Unemployment rates and employment rates (15–64), 1990–2008
Data source: OECD.stat

Altogether, employment rates had thus risen 10 percentage points in Finland and around 5 points in the other countries since 1994 (Figure 8.1) and were in full-time equivalents markedly higher than in any other EU countries prior to the financial crisis (Hemerijck and Eichorst 2010: 312). Still, in Sweden and Finland employment rates remained well below the 1990 level, illustrating how long it can take to regain the losses after a major slump. The largest difference in employment rates compared to other European countries was among women and seniors (55–64), but the Nordic countries also showed higher employment rates among the low-skilled than other European countries and even the US (Barth and Moene 2012: 28). As a corollary, by 2001 unemployment had more than halved since 1994 (Figure 8.1). After a brief rise in the early 2000s, the decline continued, so that by 2008 the unemployment rates in all four countries were well below the EU-15 level, although unemployment in Finland and Sweden remained substantially higher than in 1990.

While the deep slump in the early 1990s engendered a rise in temporary contracts in Finland and Sweden, the Nordic recovery came along with a falling trend in part-time and temporary employment shares. In Sweden, however, temporary work rose again after further liberalization in 2007. Amid solid growth in real wages,[24] earnings differences for full-timers increased in the 2000s—mostly in the lower end, especially in Norway and Denmark—but by 2008 the differentials were still the lowest in the EU (OECD.stat; see also Figure 11.9 this volume).[25] Labor market divisions between insiders and outsiders were lower than in most other EU countries (Häusermann and Schwander 2012:46) and intergenerational income mobility was higher than in the USA and UK (Bratsberg et al. 2006). Also, inequalities in household disposable incomes widened in the 2000s, except in Norway, but remained among the lowest in the EU.[26] Due to rising top incomes—mostly from capital and imputed rents in particular—market income inequalities widened more, but these were partly offset by the tax and transfer system (OECD 2011a; Kvist et al. 2011: 201–05).

The Nordic labor market recoveries in the 1990s were the result of many factors. First, the huge currency depreciations in Sweden and Finland, together with the low-inflation policies and return to coordinated wage restraint, improved competitiveness and spurred export-driven growth.[27] In Sweden, the rise in external demand was equivalent to a stimulus of 6–8 percent of domestic GDP (Krugman 2011). After profound restructuring, the Nordic industrial structures apparently fitted well to the pattern of demand growth emerging with the rise in ICT-industries, services, and the Chinese economy (Erixon 2011; Mjøset 2011). While cheaper imports reduced inflation, and the deregulation of product markets enhanced economic efficiency

[24] Average real wages for 1990–2008 rose by 27.7 percent in Denmark, 27.2 in Finland, 33.8 in Sweden, and 49.2 percent in Norway, compared to 38 percent in the UK and 17.3 in Germany (OECD.stat).

[25] By 2008, the D9/D1 ratios were 2.3 in Norway and Sweden, 2.6 in Finland and Denmark, compared to 3.2 in Germany and 3.6 in the UK (see Figure 11.9 this volume).

[26] Gini indexes increased from 0.21–24 in the mid-1990s to 0.24–26 in 2008, compared with 0.29 in Germany and 0.35 in the UK (OECD.stat; see also Figure 11.10 this volume).

[27] Export growth 1993–2000 exceeded 75 percent in Finland and 67 percent in Sweden, spurring re-industrialization. A similar, weaker shift was seen in Norway, and a few years earlier in Denmark.

and productivity (Holmlund 2009)—as regards productivity, at least by conventional measures, Denmark was an exception in the 2000s—the employment recovery was facilitated by solid demand growth in domestic markets also, especially in Norway and Denmark. The recovery in Sweden was slower due to stricter consolidation policies (Flodén 2012). The tax reforms were considered "growth and employment friendly." When the recovery took hold, rising public revenues gave room for demand-stimulating expenditure growth. In the 2000s, growing oil revenues in Norway and Denmark, credit liberalization, tax reliefs, and eventually the financial boom also fueled domestic demand.

Second, after a period of labor shedding through early retirement related to the slump, the employment recoveries were facilitated by social model adjustments. The supply of labor and skills was increased through reforms in education, activation, and family-work reconciliation policies, while expanding public services stimulated both supply and demand, for female labor in particular. Restructuring was facilitated by generous income security schemes and strong tiers of company-bargaining.[28] Although a certain polarization of the occupational structure was discernible (Asplund et al. 2011: 17), the interaction between these demand- and supply-side factors helped curb the rise in low pay employment and dualization seen in many other countries (Salverda and Mayhew 2009). In Nordic comparison, Denmark scored highest on labor mobility, but Norway displayed results almost as good and markedly better than Sweden and Finland (Berglund and Furåker 2011). As Norway was behind both Denmark and Sweden with regard to conventional "flexibility" indicators, this suggests that the demand side plays a crucial role in the way supply-side institutions affect labor market outcomes. Apparently, the much deeper crisis in Finland and Sweden engendered more lasting hysteresis effects, reduced mobility, and stronger tendencies toward dualization—influenced by the liberalization of temporary work (Berglund and Furåker 2011). In Sweden, more restrictive fiscal policies and less emphasis on ALMP also seemed to hamper employment recovery, especially among new entrants (Berglund and Esser 2014; Lindvall 2012).

8.2.7 *Summary: The State of the Nordic Models Prior to the 2008 Crisis*

Looking at the Nordic models by 2008, the doomsday scenarios of the early 1990s were not borne out. The economies had recovered, and the social

[28] The Rehn–Meidner mechanism was particularly clear in Finland, where homogeneous pay increases left a huge profit margin in the ICT industry that increased its productivity fast, encouraging investments and worker flows to this sector. Finland was, after Germany, the Eurozone country where unit costs fell strongest from 1998.

models were adjusted but essentially intact. Job growth was strong, unemployment reduced, and public finances were solid. In spite of some widening, wage differences remained comparatively low, while rising capital income in the top of the income ladder and lower employment rates in the growing immigrant populations had widened household disparities. The Nordic trajectory of consolidation was a result of incremental adjustments and political compromises rather than of grand design, reflecting the institutionalized balance of power among the social partners and the main political parties. Several of the changes in the 1990s, such as the emphasis on wage moderation, fiscal prudence, low inflation, and activation represented a return to old Nordic virtues, complemented by strengthened investment in education and work-oriented social policies. While social democrats were in charge under the rebuilding in the 1990s, the center-right returned to office in the 2000s, pledging to defend the models and improve their performance. Stronger emphasis on tax relief, benefit tightening, and outsourcing of public services did not amount to a systemic shift, but the reforms in the Swedish and Danish Ghent systems challenged more basic features of the Nordic models. In parallel, the increase in labor immigration had heightened tension in working life, while rising welfare chauvinist parties posed new dilemmas for both the left and the right. The benign economic landscape also hid national differences and relative failures. For example, Denmark's macroeconomic policies were too loose during the ante-2008 boom, when financial liberalization got out of control like in Finland, Sweden, and Norway two decades earlier. Finland had also done too little, by Nordic standards, to prepare for the inevitable demographic transformation (Kangas and Saloniemi 2013).

8.3 The Great Recession: Impact and Responses

The small and open Nordic economies (except Norway) were hit hard by the global financial crisis and its aftershocks in 2008–09.[29] With the exception of Denmark (and Iceland), where the bursting of a housing and banking bubble brought the economy into long-lasting contraction, the crisis came as an external shock for the Nordic economies. Finland, Norway, and Sweden were also mostly bystanders to the direct symptoms of the banking crisis. Since their huge banking crisis of the 1990s had resulted in more stringent financial regulation and more cautious investor behavior, their banking systems were relatively well equipped to face the crisis. After a swift rebound in 2010–11, the economies in Denmark, Finland, and Sweden ground to a new

[29] We do not discuss Iceland, which suffered a most dramatic financial collapse (Olafsson 2011) but nonetheless recovered slightly faster than Denmark and Finland as regards GDP at fixed prices.

halt until a slow recovery took hold in fall 2013, except in Finland which was still in recession in Spring 2014. In this section we review the main economic effects and policy responses in the first and second phase of the crisis, and then look a bit closer at adjustments in labor markets and social policies.

8.3.1 *First Phase of the Crisis: Deeper Downturn than in the Eurozone*

In Sweden, Finland, and Norway the first phase of the crisis mainly came as a shock in manufacturing exports, followed by a flattening of growth in private consumption and construction. Being heavily dependent on selling investment goods, Finnish and Swedish exports were especially hard hit. Denmark had a less vulnerable export structure, but suffered a larger fall in GDP in 2008–09 than Sweden and the Eurozone as a whole, due to the burst of a housing and credit bubble. Except in Norway, the downturn brought greater increases in unemployment than in most comparable continental countries. The aggregate demand components of the Nordic economies during the initial shock are depicted in Table 8.2.

Having developed strong fiscal positions prior to the crisis, the Nordic countries were able to cushion the shock by easing fiscal policy and letting their large automatic stabilizers work (Cameron 2012). This alleviated the effects of the crisis and contributed to the subsequent rebound in 2010 and 2011. However, the discretionary fiscal measures were moderate in international comparison, especially in Sweden and Denmark. This cautious approach partly reflects the effect of the strong automatic stabilizers (Andersen and Holden 2010), partly the reliance on monetary policy which is a strong stabilization instrument in the floating exchange rate regimes of Norway and Sweden. The fiscal responses are summarized in Table 8.3. The first column records the discretionary fiscal stimulus (according to a standard measure: the change in the cyclically adjusted budget balance) and the second column displays the change in the general government financial balance. The

Table 8.2 GDP growth and demand components in 2008–2009, the first phase of the recession. Annual percent change

	Real private consumption 2008	Real private consumption 2009	Export volume 2008	Export volume 2009	GDP growth 2008	GDP* growth 2009
Denmark	−0.3	−3.6	3.3	−9.5	−0.8	−5.7
Finland	1.9	−2.9	5.8	−21.3	0.3	−8.5
Norway	1.8	0.0	0.1	−4.2	0.1	−1.6
Sweden	−0.1	−0.2	0.4	−12.5	−0.8	−5.0
Eurozone	0.4	−0.9			0.3	−4.3

Source: OECD Economic Outlook, May 2013 and 2014

Table 8.3 Fiscal adjustment and discretionary stimuli during the initial phase of the recession

	Change in general government cyclically adjusted balance 2008–10, % of potential GDP	Change in general government financial balance 2008–10, % of nominal GDP	Crude measure of the automatic stabilizer 2008–10, % of GDP
Denmark	−1.8	−6.0	−4.2
Finland	−4.1	−7.1	−3.0
Norway	−1.0	−7.7	−6.7
Sweden	−0.5	−2.2	−1.7

Note: the change is calculated as the balance 2010 minus the balance 2008.
Source: OECD Economic Outlook, May 2013

difference between the two quantities is a crude measure of the impact of automatic stabilizers. In Norway, the stimulus package of the Red-Green government consisted mostly of expenditure increases—i.e., classical Keynesian policies—whereas those of the more liberal governments in Sweden, Denmark, and particularly Finland were tilted more toward tax cuts, many of which would in fact become permanent. The demand impact of the automatic stabilizers was probably more important.

In parallel, all central banks slashed interest rates. Thus, Finland as a Euro member, Denmark shadowing ECB, and Norway and Sweden as inflation targeters all enjoyed a loose monetary policy, most pronouncedly in Sweden.[30] For Sweden, a transitory but well-timed extra stimulus was provided by the depreciation—of unanticipated scale—of the krona at the onset of the crisis, particularly against the Euro (more than 15 percent by early 2010). A similar but weaker effect helped Norway in 2009. Finland and Denmark, by contrast, experienced a reverse effect, with the Euro appreciating in 2009 and then falling. After 2009, the exchange rate between the Swedish krona and the Euro (including Finland and Denmark) returned to its former trend. The Norwegian krona appreciated in 2011 and 2012, but fell significantly in 2013.

In Denmark, Finland, and Sweden, the downturn in 2008–09 prompted larger increases in unemployment than in most comparable continental countries (Figure 8.4 below). Yet, in perspective, while the 2009 drop in production was comparable to that of the 1990s slump, unemployment increased less. There were several reasons for this. Many Nordic firms engaged in labor hoarding (see Section 8.3.3)—sensibly interpreting the recession as a transitory shock—and public employment expanded in all countries until 2010 when Denmark tightened public consumption substantially. In Norway, large investments in the offshore sector sustained employment. In Finland, by contrast, the recession coincided with retirement of the exceptionally large cohorts born between 1947 and 1951, mitigating the rise in open unemployment. In Denmark, pupils and students, who often used to take sabbatical years between high school and further education, and work as much as possible in their leisure time while studying, served as a buffer.

[30] In 2009 interest rates were cut to 0.25 percent in Sweden, 1.00 in Finland, 1.05 in Denmark, and 1.25 in Norway. From 2010 onwards, the rates were raised to ECB levels in Sweden and higher in Norway.

8.3.2 *Second Phase of the Crisis: Rebound and a New Dip*

After the slump in 2009, the Nordic economies started to recover in 2010 and 2011 (Figure 8.2). In this phase, employment increased significantly in Sweden and Norway, whereas employment went on shrinking in Denmark and stagnated in Finland (Figure 8.3 below). By Fall 2013, employment in Sweden and Norway was respectively 2.4 and 3.5 percent higher than in the pre-crisis peak in 2008. In Denmark, by contrast, employment had declined 5.8 percent and in Finland some 3 percent, compared with a 3.5 percent decline in the Eurozone.

The nascent recovery was cut short by the second phase of the crisis, when the initial fiscal stimulus was replaced by austerity in most Eurozone economies and uncertainty about Eurozone banks and sovereigns rose again. Now, Denmark and Finland displayed markedly weaker output and employment performance than Norway and Sweden. In Denmark, this was a result of zero growth in private consumption and significant decline in public consumption. In Finland, sluggish export growth was the main cause, as is apparent from Table 8.4.

While fiscal policy impulses were generally moderate, it is noteworthy that Finland shifted course from a discretionary stimulus to a more restrictive

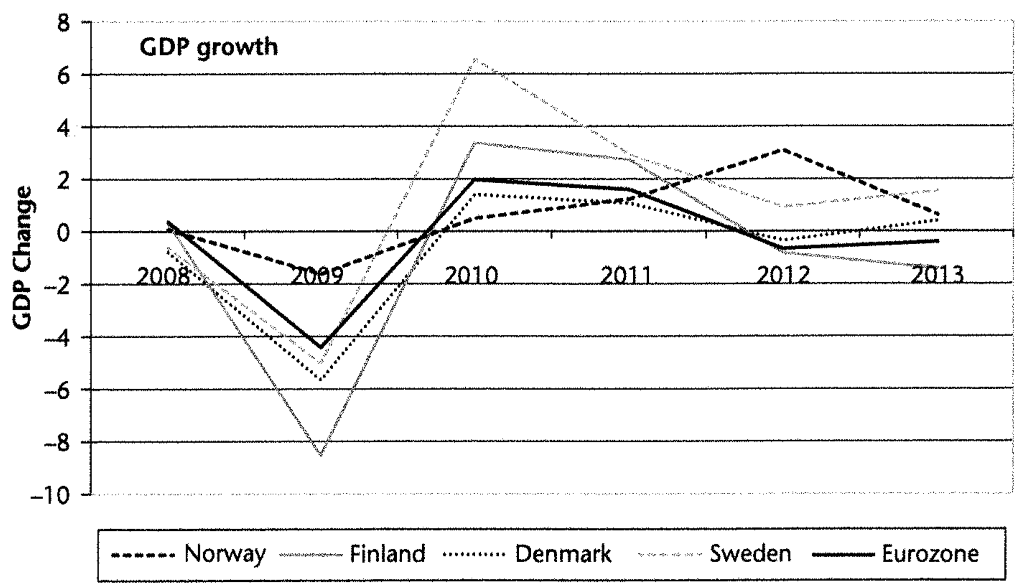

Figure 8.2 Annual GDP growth 2008–2013 in Nordic countries and the Eurozone
Source: OECD.stat

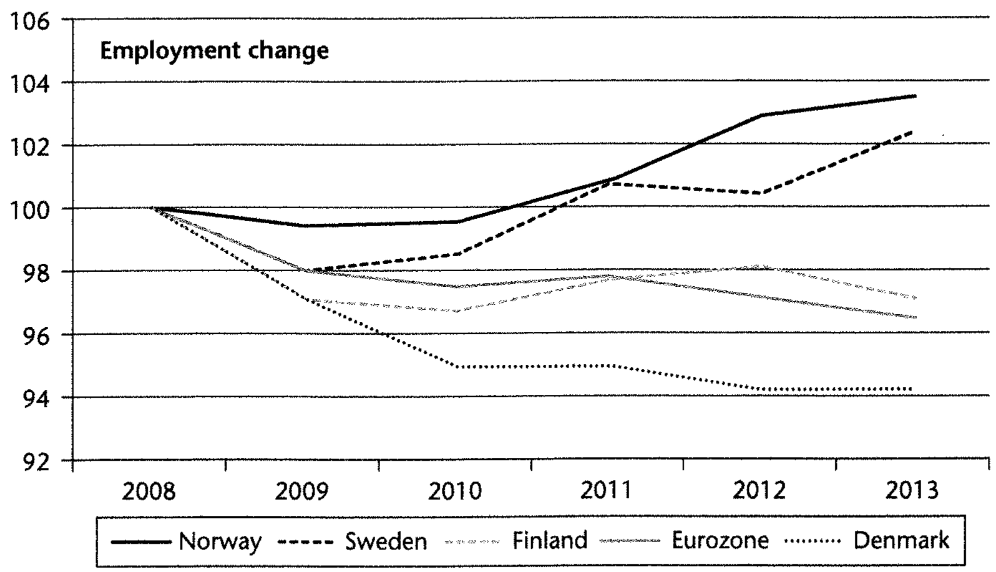

Figure 8.3 Change in employment in the Nordic countries and the Eurozone 2008–2013
Index numbers, 2008 = 100
Source: OECD.stat

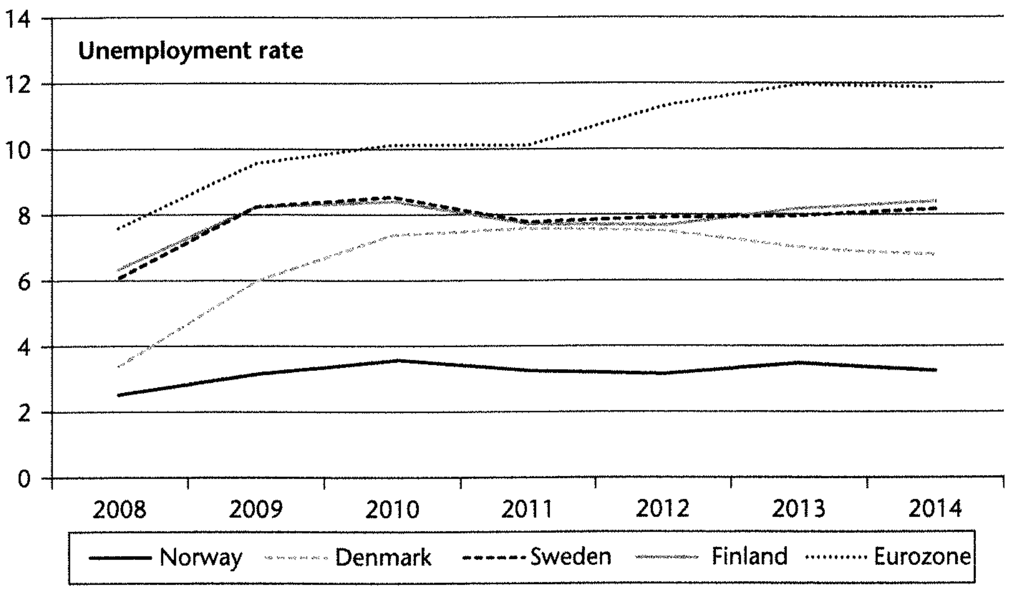

Figure 8.4 Annual harmonized unemployment rates 2008–2014Q1, Nordic countries and Eurozone (percent)
Source: OECD.stat

stance in the second phase (Table 8.4). This would seem to correspond to a "European" austerity pattern—and the EU did in fact recommend Finland to strengthen its fiscal consolidation efforts—but one should be cautious in interpreting this solely as a result of European constraints. Faced with slow growth

Table 8.4 Aggregate demand components and fiscal stimuli in the second phase of the recession, 2011–2013

	Average real private consumption growth 2011–13	Average export volume growth 2011–13	Average real total domestic demand growth 2011–13	Change in general government cyclically adjusted balance 2010–13, % of potential GDP	Change in general government cyclically adjusted balance 2008–10, % of potential GDP
Denmark	−0.3	2.9	0.2	+1.8	−1.8
Finland	0.7	1.0	0.7	+1.0	−4.3
Norway	2.6	−1.2	3.3	+0.2	−1.0
Sweden	1.8	2.2	1.8	−1.0	−0.7

Notes: Arithmetic averages of growth rates. The change in the cyclically adjusted balance is calculated as the balance 2013 minus the balance 2010.
Source: OECD Economic Outlook, May 2014

prospects because of industry-specific shocks—hitting the Nokia-cluster and forest industries in particular—as well as a stagnating labor force in the years ahead, Finnish policy-makers would probably have been concerned with the economy's long-term fiscal sustainability even in the absence of Brussels rules. It is also worth noting that the center-right government in Sweden loosened its fiscal policy slightly in 2011–12, whereas the Red–Green government in Denmark did the opposite despite much weaker domestic demand.

After the nascent recovery in 2010–11, Nordic unemployment increased slightly in 2012, but in 2013 it turned downwards in Denmark and remained low in Norway whereas it rose further in Finland and modestly so in Sweden well into 2014 (Figure 8.4 above). By April 2014 harmonized unemployment rates thus stood at 8.5 percent in Finland, 8.2 percent in Sweden, 6.5 percent in Denmark, and 3.3 in Norway, compared with 7.2 percent in the Netherlands, 6.6 percent in the UK and 5.2 percent in Germany (OECD.stat). However, when a weak recovery took hold in Fall 2013, the economic outlooks were by European standards relatively positive, except in Finland. Generally speaking, the Swedish and Norwegian economies stood out positively within the Nordic family and Europe, whereas the effects of the recession in Denmark and Finland were more prolonged, albeit for highly different reasons (Figure 8.5).

In the Danish case, the economy entered the financial crisis with a self-inflicted problem of asset price inflation. Prior to the crisis, the Danish government pursued loose pro-cyclical policies. Combined with the liberalization of asset-based borrowing, this contributed to housing and banking bubbles (Dam et al. 2011; Goul Andersen 2013).[31] The stabilization failure was exacerbated by the Danish currency peg to the Euro which prevented the Central

[31] Interest-only loans were introduced in 2003, followed by an average increase of housing prices of 60 percent 2004–06.

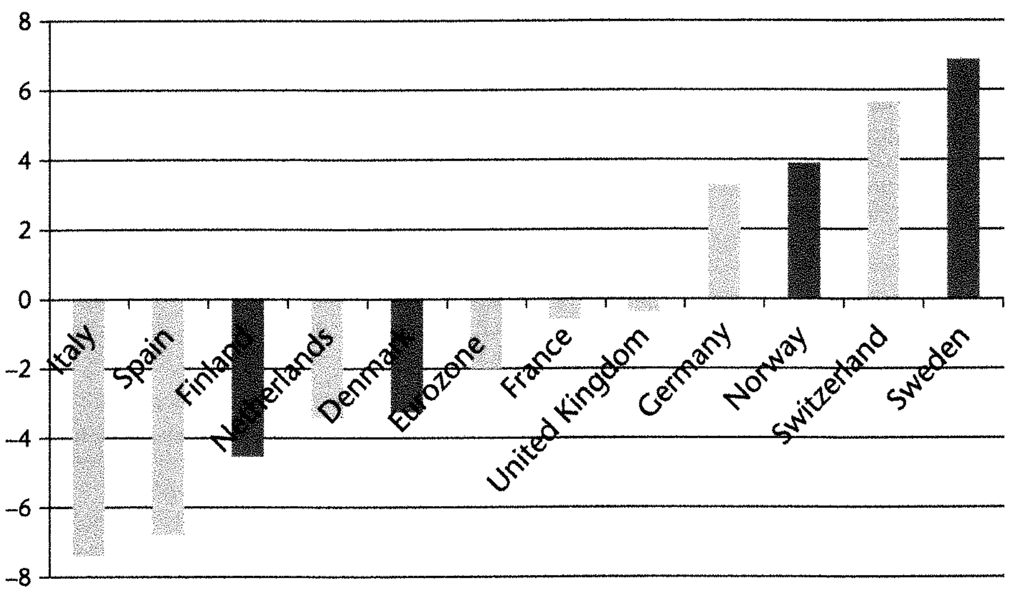

Figure 8.5 Total change in GDP during the crisis 2009–2013 (year-on-year changes in percent)
Source: OECD.stat. Economic Outlook, June 2014

Bank from using the interest rate instrument. Danish homeowners were the most indebted in the world,[32] and, typically for an overheated economy, private consumption plummeted when crisis struck. By 2013, it remained 3.3 percent below the 2007 level, as compared to a growth of 4.2 percent in Finland and 9.3 percent in Sweden (OECD.Stat). Although Denmark maintained a current account surplus of more than 6 percent 2010–13, partly due to a positive Net International Investment Position, the post-overheating and deleveraging strain prolonged the slump, and in 2013 GDP remained 4.0 percent below 2007. Against this background, the Danish fiscal stimulus was, even under the center-left government elected in 2011, rather weak by Nordic "Keynesian" standards, especially when considering that monetary policies were relatively less expansionary than in Sweden and Norway. Nonetheless, after five years of zero-growth, a weak recovery seemed to take hold from Fall 2013.

Finland's GDP and employment also lay well below their pre-crisis peak and were still shrinking when entering 2014 (Figures 8.2 and 8.3). Finland's exports were hit particularly hard during the crisis, since it coincided with Nokia's problems in the smartphone market as well as the structural crisis in

[32] This should, however, be viewed in light of the fact that Denmark also has the largest pension savings in the OECD, approaching 200 percent of GDP by 2012 (Goul Andersen 2013; *Forsikring & Pension* 2013).

the paper and pulp industry. Besides, the stagnant Finnish employment and output was strained by supply-side factors. Due to its corporatist administration of the pension system, Finland has been less proactive in dealing with its ageing problem, while immigration remained low compared with other Nordic countries. Around 2010, Finland's working-age population had begun to shrink. Thus, while Finnish unemployment figures closely tracked those of Sweden during the crisis, employment shrank 2008–13 (Figures 8.3 and 8.4). The lackluster medium-term prospects emanating from the interplay of these demand- and supply-side weaknesses apparently motivated the government's (slightly) contractionary fiscal policy stance during the latter phase of the crisis—further restraining domestic demand (Table 8.4) and prolonging the recession. Although it is difficult to blame the Euro-crisis for the depth of the Finnish recession, its Euro membership seems to have made it more difficult to develop coherent macroeconomic and wage policies in turbulent times.

8.3.3 *Labor Market Adjustments During the Crisis*

Although the number of jobs in Sweden and Norway increased during the crisis, the employment rate (15–64) declined in all the Nordic countries during 2008–12, mostly among men. In 2013, the employment rate started rising in Sweden (0.9 points) but decreased further in the other countries; when entering 2014 the overall decline during the crisis was by far strongest in Denmark (ca 6 percentage points), compared to a fall of 2.3–2.5 points in Finland, Norway, and the Eurozone, and virtually no change in Sweden. The Norwegian decline may seem puzzling, since employment increased strongly, but part of the reason is the huge influx of European labor migrants. Labor migrants are incompletely covered by the Labor Force Survey measuring employment rates, but they have apparently contributed to a drop in employment rates among youth and other marginal groups in the Norwegian labor market, including earlier immigrants (Bratsberg and Raaum 2013).

In contrast to most other EU countries, labor market participation (15–64) fell in Denmark 2007–12 (1.5 percentage points), and slightly in Norway and Finland, whereas it increased in Sweden (OECD 2013f). The rather similar unemployment figures for Finland, Sweden, and Denmark thus mask quite differential patterns as to employment and labor force growth (Figures 8.3 and 8.4). While both employment and the labor force decreased in Denmark and Finland, they increased in Sweden (OECD 2013f). Further, in Denmark, around 6.5 percent of the labor force took part in active labor market measures in 2011, compared to 4.4 percent in Finland and 3.8 percent in Sweden. Denmark thus used twice as high a share of GDP on ALMP as Sweden, Finland, and any other European country.

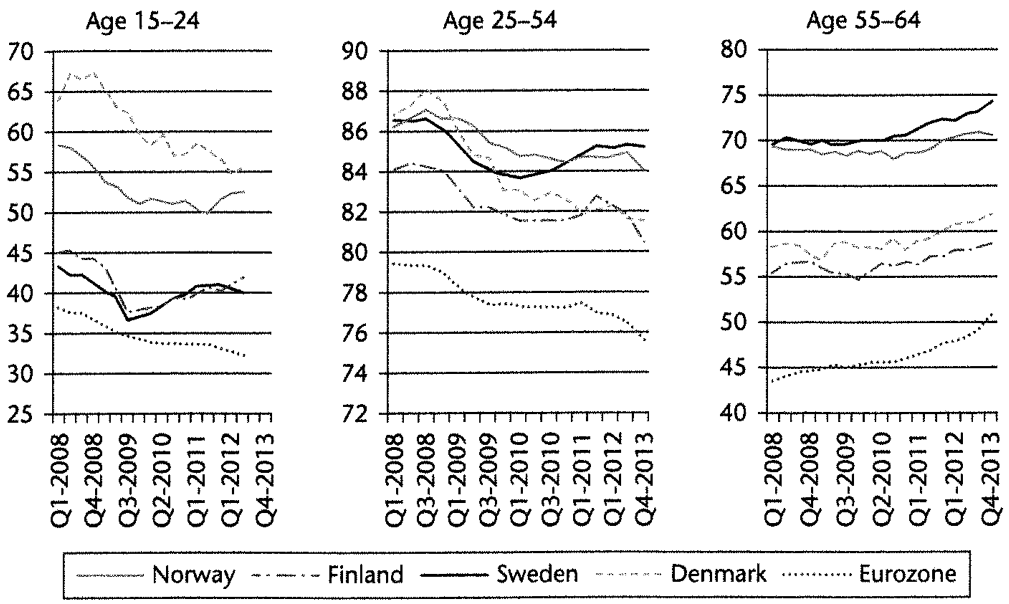

Figure 8.6 Employment rates by age in Nordic countries and the Eurozone 2008Q1–2013Q4
Source: OECD.stat

Looking at age groups (Figure 8.6), the large 25–54 group and the 15–24 youth group showed falling employment rates, whereas the rates among the elderly (55–64) increased in all European countries. Due to high shares in education and many part-time working students, the rates of employment and unemployment among youth (15–24 years) are elusive measures. From very different levels, all countries showed a marked decline in youth employment. Compared to the Eurozone, the decline in Sweden and Finland was moderate. In Denmark and Norway, where youth employment is highest—partly because apprentices count as employed, partly because most students work part-time and (during prosperity) took sabbaticals before entering higher education—the rates fell much more. Thus there is only a weak connection between the changes in employment and unemployment rates among youth (Table 8.5), reflecting underlying shifts in labor market participation. In Sweden, rising participation and larger cohorts implied that youth unemployment rates increased much more than the employment rates decreased, while the opposite happened in Denmark and Norway.

Calculated as share of the youth population (15–24), 12.4 percent of Swedish youth, almost 10 percent of Finnish and Danish youth, and 5 percent of Norwegian youth were unemployed in 2012, compared to 10.4 percent in the Eurozone as a whole. These are worrying figures, although the long-term share of youth unemployment remained below 10 percent in the Nordic countries, compared to almost 30 percent in the UK, France, and other continental

Table 8.5 Youth (15–24) unemployment rates (UER), employment rates (ER), unemployed as share of youth population 2008–2013 and NEETs 2011, Nordic countries and Eurozone

	UER2008	UER 2013	Change in UER 2008–13	Change in ER 2008–13	UE 2012, %-share of population	NEETs 2011*
Denmark	8.0	13.0	5.0 points	–12.7 points	9.0	8.6
Finland	16.2	19.6	3.4 points	– 3.2 points	9.4	9.7
Norway	7.5	9.1	1.6 points	– 5.5 points	5.0	6.8
Sweden	20.2	23.5	3.3 points	– 0.5 points	12.4	9.7
Euro-zone	15.6	23.7	7.1 points	– 6.1 points	10.5	(12.9 EU)**

*< http://www.oecd.org/youth.htm>, ** European Foundation, 2012.
Source: OECD.stat

countries. The NEET[33] rates in the Nordic countries were also lower than in the Eurozone , since a higher share of the jobless Nordic youth were in (some kind of) training or education.

8.3.4 *Institutional Adjustment and Negotiated Workforce Flexibility*

In contrast to the 1990s, the crisis did not incite tripartite crisis pacts. Finnish and Swedish employers even called for local wage increases only. In all countries the unions offered wage restraint. In many instances they agreed that strained firms could refrain from central increments. To safeguard jobs, local unions entered accords allowing new forms of working time and pay flexibility.

Initially, many companies saw the crisis as a temporary shock and tried to hoard personnel and skills (Svalund et al. 2013). In line with the "flexicurity" logic, this was less pronounced in Denmark, contributing to the sharper rise in unemployment there. In hard-hit manufacturing and construction, local actors consented to burden-sharing through shorter working hours and rotating layoffs, facilitated in Finland and Norway by government easing of the criteria and costs for temporary layoffs. While Denmark made only minor adjustments in job-sharing arrangements, Sweden, exceptionally in Western Europe, had no such scheme. In Finland, temporary layoffs funded by unemployment insurance are almost cost-free for employers and involved almost 4 percent of the workforce (90,000) during 2009, compared to 18,000 in Denmark and Norway (Svalund et al. 2013).

In Sweden, lacking a temporary lay-off scheme, demands from large local unions spurred in 2009 IF Metall to negotiate a path-breaking "crisis agreement," allowing local actors to negotiate 20 percent reductions in working hours with corresponding pay cuts. This enabled firms to save costs and retain skilled labor, while distributing the earnings losses among union members.

[33] NEETs – not in employment, education and training.

Such arrangements to boost internal flexibility were novelties in Sweden and involved 70–80,000 employees in the metal sector in 2009 (Svalund et al. 2013). In the turbulent 2010 bargaining round, employers again called for local pay-bargaining only and prolongation of the "crisis agreement," but were met with firm union opposition and demands for restricted use of agency workers (Lyhne Ibsen et al. 2011). A modest accord that curtailed agency work was reached, but coordination under the Industry Agreement temporarily broke down. In early 2012, however, unions and employers in manufacturing signed a new agreement on how to tackle crises, enabling larger working time cuts contingent on partial pay replacement. The precondition was that the government should co-finance the costs, and in February 2013 the center-right government tabled a legislative proposal to establish a short-time work and training scheme in instances of severe recession. This was part of a Job Package agreed with the unions. The deal also contained a new subsidized scheme for "introduction" jobs and training for young hires[34] and a legislative proposal to reverse the contested differentiation of unemployment insurance fees adopted in 2007 (Lagrådsremiss, May 30, 2013). Thus, by 2013 the Swedish unions seemed to regain some of the ground lost prior to the crisis, indicating that even center-right governments in the Nordic countries are often compelled to come to terms with their strong union counterparts when times get rough.

In Denmark too, the links between governments and unions were strained during the crisis, not least due to the 2010 cuts in unemployment benefits (see Section 8.3.5). This sparked a shift in union strategy in the 2010 bargaining round when they obtained strengthened job and income security by rises in severance pay supplementing benefits up to 85 percent of previous pay. Such replacement reliant on tenure signaled a departure from previous notions of "flexicurity." There were also indications that local actors gave more priority to internal flexibility (Lyhne Ibsen 2011: 45), and that divisions between core and peripheral staff were sharpened (Ilsøe 2010). In 2012, the new center-left government failed conspicuously when inviting the social partners to strike an agreement to improve long term budget balance by the prolongation of the working week, or by skipping a holiday. Amid high unemployment, falling real wages, and anger that the government had accepted the cuts in unemployment benefits launched by its predecessor, the metal-workers' union ultimately refused to sacrifice their members' leisure time for nothing. With thousands of unemployed about to lose benefits, in May 2013 the government adopted a temporary state-funded scheme that should ensure most beneficiaries 60–80 percent of their previous benefits for up to

[34] Such "introduction jobs" should entail 25 percent training supervised by skilled employees and a salary corresponding to 75 percent of the industry's minimum pay.

15 additional months, and by June 2014, a commission was appointed to come up with a proposal for a new system in 2016.

At the same time, a government lock-out of teachers, finally terminated by parliamentary decree, signaled a tougher line in public sector bargaining.

In Finland, the industrial relations situation had since 2007 been complicated by employers' determination to decentralize collective bargaining. In August 2013, however, in conditions of stagnating growth and exports, a traditional incomes policy settlement was concluded by the central confederations, stipulating only symbolic pay increases for the next two years. The government facilitated this by tying its inflation adjustments of income taxation to the bargaining outcome. In Norway, the center-left government was very receptive to union demands, enabling a range of measures to curb social dumping, often against employer protests. Pay rounds went as usual, but with staggering labor costs[35] and tension over relative wage growth among public and private sector employees, a tripartite commission was set up to evaluate the system, unanimously recommending a strengthened and somewhat more centralized, export-sector-led coordination to be achieved through slight procedural adjustments (NOU 2013: 13). Although the Conservative-led coalition, including the Progressive Party[36] elected in September 2013 promised little change in working-life policies, employer expectations were met when legislative proposals for more flexibility in working time and temporary hiring were tabled Spring 2014.

Like in former crises, union density stabilized, as mentioned earlier, reflecting a rise in membership in white-collar unions and a continued decline in blue-collar unions (Stokke et al. 2013; European Commission 2013d). With rising youth unemployment and high drop-out rates in vocational education, Sweden in 2011 opened for apprentice-based training, but the rise in the number of apprentices was slow (Olofsson and Wadensjø 2012: 24). Also, the Danish apprentice-based system has been struggling with low completion rates and a shortage of practice places. As all projections indicate future shortages of skilled laborers, this led the government to adopt a major reform of the system in 2014. With similar tendencies in Norway, the crisis thus spurred renewed efforts to adjust and expand vocational education toward broader programs and more practice-based learning in all four countries (Høst 2012: 159).

[35] In Spring 2013, unit labor costs were more than 60 percent above those of the main trading partners, but they subsequently fell due to strong depreciation of the Krona (NOU 2013: 13).

[36] Becoming the third largest party, with over 16 percent of the vote, this was the first time a welfare-chauvinist party calling for tighter immigration policies formed part of a Nordic government.

Thus, in our view there were no transformative changes in the institutional framework of Nordic labor market governance during the crisis. Innovative adjustments were seen, however, as illustrated by new forms of local work-sharing, flexibility, and the "crisis agreement" in Sweden. Although the weight on internal flexibility to cushion market turmoil and retain skills can be viewed as a slight shift from the emphasis on external mobility commended by the Rehn–Meidner model, the capacity for flexible adjustment once attributed to Nordic industrial relations (Katzenstein 1985) still seemed largely intact. Nordic unions have lost members and power resources, but remain strong in comparative perspective. Hence, even such a pro-market government as the Swedish one of Reinfeldt and Borg clearly appreciated the political value of finding solutions with the unions. Still, the combination of higher unemployment, labor migration, and low-wage competition in the wake of the Eurozone-crisis, alongside tension between EU law and Nordic bargaining traditions, have stirred controversy among the social partners over whether and how to shore up wage floors and stem the pressures on the Nordic employment relations systems.

8.3.5 *Social Policy Adjustments During the Crisis*

In Finland, Norway, and Sweden the crisis did not release any major change in the welfare state. The incremental labor-supply-oriented reform agenda had been there since the 1990s. In Finland though, the prolonged recession contributed to a sense of crisis that, in combination with prospects of labor-force decline, paved the way for a deal on pension reform and made the government introduce some cautious measures to boost labor supply in 2013. For example, the duration of earnings-related unemployment insurance benefits was marginally cut for some groups. Another proposal (not yet passed in Parliament by July 2014) was to divide Finnish parents' homecare allowance, so far available up to a child's 4th birthday, into two (non-transferable) halves of 1.5 years each, thus prompting more women to seek work.

This incrementalism was in some contrast to the "reform frenzy" in Denmark—to use the expression of the Danish prime minister at the 2013 World Economic Forum in Davos. The Danish reforms were not primarily related to the crisis; instead, the governments used the window of opportunity to carry through structural reforms that had long been on the agenda:

- Duration of unemployment benefits was cut from four to two years (2010), and requalification requirement doubled (but the reform was de facto not phased in by 2014);
- Early retirement allowance was de facto phased out (2011/12);

- Tighter conditions for social assistance recipients aged below 30 years (2013), extending principles previously applied to recipients aged below 25;
- Means testing of social assistance according to household criteria for unmarried couples;
- Restricting access to disability pension (2012);[37]
- Cuts in subsidies for the flexible job scheme, targeting it to people with low wages (2012);
- Tax reforms, with tax relief for the employed co-financed by a future 5 percent cut in social transfers (to be implemented 2015–22);
- Significant cuts in social services, not least elderly care (e.g., 17 percent cut in home assistance 2008–12);
- Ideas about targeting social benefits according to Anglo-Saxon ideals (so far carried through only for child benefits).

Although the Nordic countries have long been incrementally turning their welfare arrangements in a more activating direction, the Danish reforms stand out in terms of their scope, and could be seen as carriers of systemic change. However, the idea of targeting met severe resistance among social-democratic party members, and the government was pressured to postpone and modify implementation of the 2010 unemployment insurance reform, the future of which, as mentioned earlier, is to be discussed by a commission in 2014–15. The pension reforms raising the earliest retirement age from 60 years for the 1953 cohort to 70 years for the 1971 cohort—alongside restricted access to disability pension and shorter duration of unemployment insurance—can create social problems for less-skilled and less-healthy groups. To what extent the Danish reform agenda will be implemented or followed up in the other countries depends on public reactions and attitudes and not least on developments in the balance of power among the parties and social partners. The strong voter reactions in Denmark 2010–13—and the Swedish election 2014—indicate that support for the welfare state is highly resilient.

8.3.6 *Distributive Impact: Some Preliminary Indices*

Since comparable incomes data at the time of writing are only available for the first phase of the crisis, it is too early to draw firm conclusions about the distributive impact of the crisis and the political responses to it. Crises mainly affect income inequality in two ways: first, via the shifts in unemployment

[37] In 2013, the number of people awarded disability pension declined by 61 percent as compared to 2012 (Ankestyrelsen 2014).

and access to work and earnings, which tend to hit low-income groups more than others; and second, via the temporary decline in capital revenues, which mostly hits groups in the upper rungs. European studies of changes in disposable household income 2008–10 indicate that the effects of tax and transfer systems and reduced capital income cushioned the immediate inequality increasing effects of job and income losses (Jenkins et al. 2011; Basso et al. 2011).

Total household market incomes fell in all European countries but Sweden and Germany 2007–10. Among the large majority that retained their jobs in the Nordic countries, however, growth in nominal earnings, reduced interest rates, low inflation, and tax reliefs contributed to rising net incomes. In 2007–12 hourly earnings in manufacturing rose by 16–18 percent in Denmark, Finland, and Sweden, and 27 percent in Norway, compared with around 10 percent in Germany and 13 percent in the UK (OECD.stat). Thus average real wages rose in all four Nordic countries in both the first and second phase of the crisis, except for a slight drop in Denmark 2009–12 (ETUI 2013: 50).

As to wage inequalities, the ratio between the highest and lowest earnings deciles (D9/D1) among full-timers was by 2011 actually reduced in Sweden and stable in Finland. Contrary to most cases in this study, wage dispersion in Norway and Denmark increased significantly during the crisis (Table 8.6, see also Figure 11.9). The same pattern pertained to the D5/D1 ratio. As a result, Sweden showed the lowest Nordic wage differences and Denmark the highest. Although all four countries still belonged to the group with the most compressed wage structure in the EU/EEA—together with Belgium, Italy, and Switzerland—it may seem as if the combination of comparatively low agreement coverage, no general wage floor, and high labor immigration has contributed to a faster widening of wage inequalities at the lower end in Norway and Denmark, together with Germany, than in the other case countries (see Figure 11.9).

Changes in the distribution of final household income were trickier to disentangle at the time of writing. Inequality in household market incomes increased in the OECD countries 2007–10 more than in the previous 12 years

Table 8.6 Earnings differentials D9/D1 in 2007 and 2011 (full-time)

Country	2007	2011	Change in points
Denmark	2.69	2.80	0.11
Finland	2.55	2.58	0.03
Norway	2.23	2.34	0.11
Sweden	2.34	2.31	–0.03
Germany	3.26	3.33	0.07
UK	3.59	3.61	0.02

Source: OECD Employment Outlook 2013

together, and the rise in the Nordic countries was well above the OECD average (OECD 2013a). Due to the offsetting effects of taxes and transfers, however, disposable income inequality changed much less in this initial phase of the crisis.

- Among the Nordic countries, disposable household income inequality increased markedly from 2007 to 2010 in Denmark and Sweden (0.6 and 1.0 percentage points measured by the Gini index), whereas it fell slightly in Norway, and was almost unchanged in Finland.[38] The rise in Sweden was only exceeded by Spain (3 points) and the Slovak republic (1.7 points). In the working-age population, Danish inequalities increased slightly more than in Sweden. Although the gap between Sweden, Denmark, and the continental countries was narrowing, income inequalities in the four Nordic countries still remained well below all other EU countries except Belgium (OECD 2013a).
- Measured by the ratio of disposable household income between the highest and lowest income deciles in the working-age population (P90/P10), inequalities increased modestly in Denmark and Sweden 2007–10 while they were almost unchanged in Finland, Norway, and the other case countries in this book, except Italy and Spain where disparities widened sharply (OECD.stat). Disposable income among the poorest 10 percent of households fell slightly in Norway and was stable in Denmark 2007–10, while it increased 1 percent in Sweden and 3 percent in Finland (OECD 2013a). With 5–6 times higher incomes, the "top-ten" experienced a 1 percent drop in Norway, rises of 1–2 percent in Denmark and Finland, and a strong 3–4 percent rise in Sweden. Hence, the widened income gap in Sweden in this phase was primarily caused by large income rises at the top.[39]

The somewhat stronger rise in overall income inequality in Sweden may partly have to do with a marked upward shift in the Swedish job structure (Hurley and Storrey 2011)— reinforcing the concentration of unemployment among low-skilled groups—and partly with prior retrenchment of social and unemployment benefits. This was also reflected in rising relative poverty rates in Sweden (measured as below 50 percent of median household income).

[38] According to 2011 data the Gini indexes were unchanged 2010–11, while the P90/P10 ratio referred below increased slightly in Norway, fell in Finland, and was flat in Denmark and Sweden (OECD.stat).

[39] Still, by 2010 the Nordic countries, together with the Netherlands, were among the OECD countries where the 1 percent richest has the lowest share of pre-tax incomes—some 7–8 percent, compared to 20 percent in the US and 13 percent in the UK and Germany – despite solid rises in recent decades (OECD 2014c).

Table 8.7 Long term unemployed (above 1 year) as share of unemployment in Nordic and selected EU countries

	2007	2012
Denmark	16.1	28.0
Finland	23.0	21.7
Norway	8.8	8.7
Sweden	13.0	17.5
Germany	56.6	45.5
Netherlands	39.4	33.7

Source: OECD 2013f

While the rates were fairly stable at around 6 percent of the population in Denmark and 7.5 percent in Norway and Finland, the poverty rate in Sweden increased from 7.5 in 2007 to 9 percent in 2010, compared to 8 percent in Germany and 10 percent in the UK (OECD 2013a). Like elsewhere, the Nordic figures may worsen when data from the crisis' second phase become available, and more long-term unemployed lose unemployment benefits. Still, except for a strong rise in Denmark, the Nordic shares of long-term unemployed (above one year) in 2012 (Table 8.7) remained fairly low compared to most Eurozone countries, where the total share was approaching 50 percent (OECD 2013f).

8.3.7 *Taking Stock*

As shown, the financial crisis hit the Nordic countries (except Norway) hard, but its economic and political impact has differed. The Norwegian and Swedish economies were able to weather the storm better than most other European economies, whereas the Danish and Finnish economies slid into more severe problems. In Denmark this had to do with the financial bubble caused by economic policy failures prior to the crisis, and with political failure to stem the subsequent decline in private consumption, housing investments, and credit drought. For several decades, Denmark has enjoyed a lasting improvement of its terms of trade. In Finland, the problems seem to be of a more structural character, due to the decline of main export sectors—illustrated by the sale of NOKIA—and a stagnant labor force due to ageing.

As a consequence, the labor market fallout of the crisis has taken different forms. In Denmark, high net job losses and a sharp fall in employment rates were only partly mirrored in the unemployment rate—due to decreasing labor market participation among the young. Finland also experienced declining employment, but the shrinking of the labor force prevented an even sharper rise in observed unemployment. Sweden, by contrast, saw rising participation and a net increase in employment, whereas unemployment, especially among youth, remained higher than in the other countries. Norway is a special case where strong employment growth and labor immigration from the EU was accompanied by a slight decline in employment rates but only modest changes in the low unemployment rate.

In spite of its broad labor market repercussions, the recession cannot be interpreted as emanating from the Nordic social models. Regardless of business cycles and macroeconomic shocks, the Nordic countries have been incrementally and assiduously adjusting their social models. In working life, the recession spurred innovative adjustment mechanisms, such as the Swedish "crisis agreements," while rising drop-out rates in education have prompted efforts to revitalize vocational training in all four countries. The large Nordic welfare states are not viable without high employment rates. With ageing and more heterogeneous populations, this is a permanent challenge, and largely independent of the recent recession, although it may sometimes be overplayed by politicians as a justification for saving on unemployment and other benefits.

8.4 Conclusions

For many observers it is a puzzle how well the Nordic models—with their generous welfare states, large public sectors, regulated labor markets, and strong trade unions—have performed over the past two decades. Consolidating and renewing their models in the wake of their (self-inflicted) crises two decades ago, the Nordic countries recovered strongly in the 1990s and continued to top rankings of efficiency and equity in the 2000s. The Nordic economies have also emerged from the Great Recession in comparatively good shape, although the slump became more severe and prolonged in Denmark and Finland. By 2013 all four countries were ranked in the top 15 of the World Economic Forum competitiveness index, among the seven European countries with the lowest share of "bad jobs" (Eurofound 2013), and among the top ten in the OECD survey on adult skills for literacy and numeracy proficiency.[40]

What can be learned from the "first" Nordic recoveries of the 1990s? First, they show that there is no necessary contradiction between efficiency and equity. While the slump emanated from macroeconomic policy failures, the egalitarian social models were apparently no barrier to growth. Second, the Nordic countries undertook "structural reforms," but—except for the pension reforms and the incremental pushes toward more activating labor market policies—they occurred mainly in the area of product market regulation.

[40] See OECD (2013g): <http://www.oecd.org/site/piaac/#d.en.221854>.

Labor market regulation was kept almost unchanged, except for liberalization of temporary work in Sweden. Third, the most important changes were made in macroeconomic policies and wage setting where the strong social partners restored coordinated wage moderation through different forms of pattern-bargaining and incomes policies. Except in Denmark, significant currency depreciations after leaving the ECU-peg spurred export-driven recoveries that facilitated a return to balanced fiscal policies (over the cycle). Tax reforms lowered (marginal) tax rates, but the broadened tax base ensured steady revenue growth under the recovery. Contrary to what has recently been seen in the Eurozone, the Nordic countries in the 1990s managed to combine economic consolidation with revival of domestic demand, preservation of the welfare state, and investment in education, training, and work-friendly social arrangements. Some retrenchment of benefits was seen, especially in hard-hit Finland and Sweden, but the renewed emphasis on activation was mainly pursued through stricter conditionality. As a result, the Nordic countries entered the new millennium in good shape—showing strong job growth, reduced unemployment, and stable distributive outcomes—while their social models were essentially intact.

In the booming 2000s, the social-democratic governments that had presided over the recovery in the 1990s were ousted by center-right coalitions. As they had largely given up their opposition against the Nordic models, these shifts did not create much systemic change but implied greater emphasis on tax relief, "work first" policies, unemployment insurance reforms, and outsourcing of public services—most pronouncedly in Sweden. While Finland and Sweden saw taxation falling 5 percentage points of GDP 2000–10, Denmark underwent radical credit liberalization. Under rising prosperity, the growth in employment, wages, and revenues continued, but increasing capital gains at the top and immigration and benefit tightening in the bottom brought widened disparities. Alongside membership decline in unions and unemployment funds, and increasing EU labor migration, contours of new social divisions were visible prior to the financial crisis.

The Nordic economies (except Norway) were hard hit by the Great Recession in 2008–09. Thanks to the adjustments made in the 1990s and the prosperity of the 2000s, however, all four countries entered the crisis with current account surpluses and solid public finances, and could let their automatic stabilizers work, adopt countercyclical fiscal policies, and stimulate domestic demand. In contrast to Finland and Denmark, which were tied to the Euro, Norway and especially Sweden initially benefited from currency depreciations and more vigorous interest rate policies. After sharp initial growth in unemployment, the economies rebounded in 2010–11 (except in Denmark), and unemployment stabilized below 4 percent in Norway and 8 percent in the others. In Denmark growth was hampered by self-imposed restrictive

fiscal policies—eventually prolonged in line with EU recommendations—and by failure to deal with sluggish domestic demand, typical for a post-bubble economy. From 2012, the second dip in the Eurozone ground the Nordic economies almost to a halt, but from Fall 2013 a slow recovery took hold except in Finland. While the Norwegian and Swedish economies looked solid, and the Danish seemed to pick up, the prospects in Finland were less encouraging. With the effects of structural export decline accentuated by a stagnant labor force and tightened fiscal policies in line with EU recommendations, the Finnish labor market was still shrinking when entering 2014.

What can be learned from the Nordic experience under the Great Recession? First, the main problems facing the Nordic labor markets under the recession—like those faced in the 1980–90s—were clearly *not* rooted in the social models. On the contrary, by providing strong automatic stabilizers and negotiated adjustment in working life, the social models were important levers in cushioning the effects of the crisis. Still, in Sweden and Denmark, prior reforms had contributed to rising incomes inequalities. Second, although all four Nordic countries entered the recession with solid welfare state finances, the prolonged recession in Finland has caused increased strains. The extensive Nordic welfare states are preconditioned on high employment rates and their viability is likely to be challenged if unemployment remains high. Whether due to stagnant labor markets, increased immigration, or political actors viewing the recession experience as an opportunity to launch new reform agendas—as perhaps witnessed in Denmark—political pressures for more restrictive, differentiated social policies have grown. While that was largely avoided in the 1990s, changes prior to and during the crisis may suggest that the current prospects are more uncertain.

First, the high dependence on international markets makes the Nordic economies vulnerable to future external shocks, and increased international volatility can reduce the room for maneuver in economic and social policies (Freeman 2013). Tied into the Euro-regime, Finland lacks monetary policy tools and must rely on "internal devaluations" through social and wage policies to handle shocks. To some extent, the same applies to Denmark. And while Norwegian prosperity is contingent on the oil price, Swedish recovery has been fueled by surging Chinese imports. Second, looking ahead, the Danish and Swedish welfare states seem financially well-equipped to handle population ageing, while Finland and Norway will face greater challenges associated with rising expenditure on pensions, health, and elderly care (Fløtten et al. 2013; Kangas and Saloniemi 2013). Increasing immigrant populations, labor migration, and low-wage tiers in the labor market are likely to continue exerting pressures on the labor and welfare pillars of the models. With higher unemployment and declining union density, such changes may alter power relations in working life and make preservation of the egalitarian trust and legitimacy on which the social models rely more demanding. Combined with shifts in electorate behavior and party alignments that seem to favor coalitions between the center-right and welfare chauvinist parties conquering tipping positions (see Chapter 9 of this volume), such dynamics may weaken political support for the inclusive labor and welfare regimes that have distinguished the Nordic models. Third, in such a context, the reform agendas most markedly launched in Sweden and Denmark in recent years—by center-right and center-left governments alike—and the growing disparities that have followed, might open political avenues for transformative narrowing of universalism and more differentiated welfare systems.[41] In such a scenario, there is little reason to expect a wholesale break-up of the Nordic models; more likely is a piecemeal withering and retrenchment at the margins, leading to more segmented, multi-tiered social models (Kvist and Greve 2011). If so Nordic standards may be maintained for the core majority, but the divisions between insiders and outsiders are likely to deepen and the Nordic distinctiveness will diminish.

Equally plausible, however, is that the pendulum swings back, as suggested by the rising political opposition such changes have created in Sweden and Denmark. In line with theories of institutional "path-dependence" (Pierson 2000) and "resource mobilization" (Korpi 1983), large parts of the populations are still staunch defenders of the Nordic social models and have strong stakes in their preservation. With their entrenched institutions and influential trade unions, a scenario for social model transformation is likely to be contested and politically risky. Not least for the fragile center-right coalitions that have placed their stakes in defending the Nordic models and become dependent on numerous labor votes and support from welfare chauvinist parties, pursuit of such a scenario may easily boomerang—as suggested by the theories of "blame avoidance" and "credit claiming" (Bonoli 2012). Intensified competition for labor votes from the welfare chauvinist parties poses similar dilemmas for the social-democratic parties. Hence, the prospects for political forces that want a radical break-up of the Nordic social models seem bleak. In hindsight, the political dynamics thus far seem to gravitate toward the middle-ground of continued cautious consolidation and renewal.

[41] Similar reforms are discussed in Finland and Norway, where the incoming Conservative coalition is closely watching the Swedish and Danish experiences in search for "new ideas and better solutions."

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