



## **How the Nordic model weathered the crisis**

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### **Regular welfare reform and sustaining a broad political consensus underlie its continuing strength but new structural challenges remain**

Where is the welfare state heading and can the Nordic model survive? These questions are often raised in political debate. But what are the actual characteristics of the model and where do its key challenges lay? Over the last two years, a group of researchers from the five Nordic countries have studied the challenges facing their respective welfare states up over the next 15 years.

Nordmod 2030 has looked back on the welfare model's evolution over the past three decades. In this period, it has been challenged by external as well as internal political, economic and structural changes. These include the expansion of the open market in the EU with regard to labour, stronger monetary policy collaboration, the reunification of eastern and western Europe after the fall of the Berlin Wall, as well as economic growth and political change in Asia, the Middle East and Latin America. All Nordic countries have experienced significant internal changes in their political structures and demography, including in particular, the age and ethnicity profiles of their populations. One of the main conclusions of the project is that the Nordic welfare model has been able to adapt to these changes thanks to regular welfare reforms.

Looking at the last 25 years there are three main lessons we can take. First, the Nordic model has been strengthened by political dialogue, in which significant changes to it have been implemented on the basis of broad political agreement. Second, reforms have been, and will probably continue to be, an ongoing process adapted to long-term structural changes as well as to short-term cyclical fluctuations. Finally, there is a key challenge in terms of maintaining a balance between the desire to encourage people to contribute to society through working and paying taxes and the desire to maintain a social safety net of income transfers for citizens who are not able to provide for themselves.

In discussing the Nordic model an important question is whether there is actually one Nordic model at all or, in fact, a family of national models. The five Nordic countries are influenced by different

external conditions (e.g. membership of the EU); industrial structures; institutional approaches (e.g. in connection with unemployment insurance funds and pensions); and social challenges and political responses. However, the Nordic countries obviously have many common features as well, such as their values, institutions and societal players, which, compared to other European countries, have established a strong tradition of collaboration, joint problem-solving processes and the development of a strong welfare state.

The Nordmod project highlights the fact that, over the past 30 years, traditional Nordic welfare policy has been characterised by close collaboration between economic policy and labour market and welfare regulation, and that the model for Nordic welfare states is based on three inter-dependent pillars.

First, a solid macroeconomic policy based on free trade and high business activity, which has established the foundation for a large public sector, full employment, greater social equality, and high salaries and working conditions.

Second, a regulated labour market in which the parties negotiate salary and working conditions in a collective bargaining system ensuring the population a good standard of living, corporate competitiveness, high employment and labour standards and a qualified workforce.

Third, welfare policies which include universal services ensuring equalisation of living conditions, education for all, a high employment participation rate and equal opportunities as well as a comprehensive system of redistribution, providing security for citizens who do not have an income of their own.

The strength of the Nordic model is contingent on the ability to maintain a high level of employment. However, the combination of wealth and high employment, together with good social security and low inequality achieved through income redistribution and tax-financed public welfare services underlie the model. Furthermore, close collaboration between the social partners as well as between the partners and the political system is also a crucial feature.

Even though the Nordic model is well-established in Denmark and the other Nordic countries, it still needs regular adjustment. The economic crisis of the late 1980s and the early 1990s sparked in earnest reformist policy in the Nordic welfare states, which has met with not inconsiderable success. A strengthened economy, increased employment and decreasing unemployment were created relatively quickly due to joint political efforts in each country. Social and employment policies played an important role in these reforms. Obviously, this results from the socioeconomic imbalances arising from maintaining a welfare state in which a large percentage of citizens depend on income compensation benefits and do not contribute to financing the common public services through taxes. This is one of the key challenges for the Nordic welfare state, and it will continue to be so in the future.

The development of reforms has, to some extent, been shaped by political ideologies, but it is macroeconomic developments which have played the biggest part. A high level of unemployment strengthened the focus on increasing the qualifications of the workforce, and a low level of unemployment led to a drive to get everyone without a job into the labour market as quickly as possible. Changes to the model have been, and will continue to be, an ongoing process which

responds to long-term structural shifts as well as short-term cyclical fluctuations. On the face of it, this may seem like a sensible prioritisation, although this was not brought about by a conscious overall political strategy.

Nevertheless, it is worth noting that, although the detail of policy changes with the ideology of the government in office, many reforms and policy packages have been adopted with the backing of a broad political consensus. This is both characteristic of the Nordic model and necessary for rapid and efficient policy adjustment. One recommendation for politicians could be that they should make it a conscious common political strategy to ensure welfare reforms respond to both structural and cyclical developments.

To a degree, disagreement between the political blocks is based on their faith, or lack of it, in the effects of economic incentives. A characteristic feature of the reform period is that adjustments through economic incentives will have a greater impact over time. The welfare state is permanently seeking a balance between ensuring a reasonable standard of living for individuals without incomes and ensuring that people are motivated to make an effort and, as tax-paying citizens, are willing to pay the necessary taxes.

The reforms have been aimed directly at the recipients of income transfers, but they have also had a number of other significant indirect effects. One of these has been to sustain support from the general public for maintaining a fine-meshed economic safety net. New reform initiatives are likely to continue to focus on this balance. Furthermore, the level of income redistribution is expected to be under constant pressure from budget restrictions in the public sector and from a population that expect high levels of tax to be reflected in high-quality welfare services. The good, and still unanswered question, is how much can income transfers be reduced while still claiming the Nordic welfare model remains intact?

One of the more unfortunate experiences from the long period of reform is that it is very difficult to ensure the inclusion of the most disadvantaged in society. Even during an economic boom, with a considerably tight labour market, many individuals are still stuck in the income transfer system. All Nordic welfare states are facing a challenge in ensuring that citizens have equal opportunities and a desire to take part in society. Moreover, they are also faced with the challenge of combining the desire for a highly productive society with the desire for an accommodating and inclusive one. Growth and high productivity are necessary to ensure all citizens have social and financial stability. However, the requirement for high productivity also prevents citizens with limited educational qualifications from being included in the labour market.

In retrospect, the Nordic welfare states fared relatively well through the crisis in the late 1980s and in the early 1990s. However, the impact of the 2008 crisis continues to be felt. The Nordmod project shows that, despite the shock caused by the crises, the Nordic welfare states are still doing well compared to many other European countries with regards to wealth-creation, high employment, reducing long-term and youth unemployment, as well as preserving the quality of life. Viewed from an international perspective, these are still well-functioning economies with well-functioning labour markets and public sectors, which ensure a relatively harmonious, conflict-free society with a high standard of living for all citizens. However, if the Nordic countries are to do well in an ever-more globalised world, the model will have to continue to evolve. This raises two key questions: will these

adjustments be adequate to cope with the outside pressures and how far can we go before we have given up on the Nordic welfare model?

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**Two reports from the project form the basis for this article: The Time of Reforms: Adjusting Labour Market and Welfare Since 1990 Country Report on Denmark by Lisbeth Pedersen and Søren Kaj Andersen and The Nordic Model up to 2030: A New Chapter? by Jon Erik Dølvik, Tone Fløtten, Jon M. Hippe and Bård Jordfald**