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Labor and the Nordic Model of Social Democracy

Introduction

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Michael Wallerstein had a long-term research interest in social democracy in the Nordic countries, a theme that we worked on together for many years. Our first paper on the topic praised the Nordic achievements, but claimed that social democracy was in retreat. As we saw it, "both the egalitarian distribution of income and the security of income that distinguished social democratic societies from other capitalist democracies are declining" (Moene and Wallerstein 1993a: 231–232). As time went on and we continued our work, we became less certain that the era of social democracy was actually over, and more certain that whatever the future of the social democracy in Europe, the Nordic lessons were highly relevant for social reformers in other parts of the world, including developing countries.

The societal model of northern Europe goes under many names. While the Swedes call the system the "Swedish model," the Danes and Norwegians insist on the "Scandinavian model." More recently, representatives of the European Union have started to use "Nordic model," which now seems to be the most popular term. Outside Europe the model is best known simply as "social democracy," a term that most Europeans associate with specific political parties and ideologies rather than with an economic and political system.

Social democracy in the Nordic countries is strong evidence for the achievements of unions as opposed to workers' ownership. The success of unions may seem obvious today, but to many early leaders of the labor movement in the nineteenth century, worker cooperatives were as relevant a goal as extensive union membership – and just as distant. But while unions grew to become important actors in the labor markets of northern Europe and elsewhere, worker cooperatives remained on the margins.

One of the first joint papers that Michael Wallerstein and I wrote explored why worker cooperatives are so strikingly absent where unions are particularly strong. We emphasized that without unions able to enforce a floor on wages throughout the economy, competition and free entry would drive the returns to labor down to their competitive level whether firms are owned by the employees or the shareholders. Thus, unions provide a smaller share of a bigger pie, and union leaders consider workers' cooperatives as a threat to union solidarity (Moene and Wallerstein 1993b).

A comprehensive union movement is indeed an important characteristic of the Nordic model of social democracy. Yet one should not underestimate the importance of strong employer associations to the system. Together the two parts of the labor market tend to take wages out of competition by way of centralized wage negotiations. The role of employers is often forgotten by the critics of the system. If the employers so desired, they could easily dissolve the system by withdrawing from central wage negotiations.

In addition, the Nordic model is distinguished by a large welfare state and a system of routine consultation among government and representatives of interest organizations. Its policies include wage leveling through "solidaristic bargaining," the provision of basic goods for all citizens as a right of citizenship, and a government commitment to full employment.

Wallerstein and I wanted first of all to explain how the Nordic countries achieved the most egalitarian wage distribution and the most generous welfare states in the world without obvious macroeconomic costs. We focused on the key institutions and policies that have dominated northern Europe since the Second World War. We wanted to emphasize the general lessons and to resolve the many puzzles that are associated with the Nordic model of social democracy.

The lessons for mainstream economics may be particularly harsh. The Nordic countries of Denmark, Finland, Norway, and Sweden seem to violate what the economics profession has long viewed as necessary requirements for an economy to prosper. Their wage differentials are too small, their taxes are too high, their public sectors are too large, their welfare states are too generous, and their unions are too strong. Despite these violations, the Nordic countries have for decades done extremely well. What most economists see as a recipe for serious economic trouble seems, in the Nordic countries, to be consistent with high growth, low unemployment, low inequality, and a fairly efficient allocation of resources.

So, has economics got it wrong? Or are the Nordic countries just a special case? Clearly, economics cannot have gotten it universally right, and the Nordic experience may be a good example of why and how. But the Nordic lessons should be interpreted with caution. The lesson is not that there is a universal positive relationship between equality and economic performance. The lesson is that under some institutional arrangements, equality and prosperity go together and reinforce each other. Under other institutional arrangements this is not the case. A narrow economic approach, however, that neglects institutional complementarities and social spillovers does not capture such mechanisms and may easily misinterpret the Nordic experience.

Several complementarities between institutions and policies make Nordic social democracy a broader societal model. On the one hand, it would be difficult to maintain full employment in the Nordic countries without a comprehensive union movement that provides wage moderation in central wage negotiations even when unemployment is low. Full employment, on the other hand, is important for central union leaders to obtain wage moderation without too much resistance among their members. All this can be viewed as a mutual gift exchange (Moene and Wallerstein 1993a).

A comprehensive union movement would also lobby for generous welfare state arrangements. Yet the greatest influence of unions on welfare spending comes via their wage policies. The Nordic countries' unions have a much stronger influence on the distribution of wages among workers than on the functional distribution of income between labor and capital (Wallerstein 1999; Moene and Wallerstein 1995). And in turn, the distribution of wages among workers has a strong influence on welfare spending. The small wage differentials that centralized wage setting creates provide support for universal welfare state arrangements (Moene and Wallerstein 2001, 2003a). The generosity of the welfare state, on the other hand, supports weak groups in the labor market, which compresses the wage distribution even further. Together the two sides can generate an equality multiplier (Barth and Moene 2006).

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

These are all examples of how policies, institutions, and behaviors fit together and strengthen one another. One can argue, as we did, that they constitute a form of institutional equilibrium. Still, one may wonder whether such an institutional equilibrium supports lasting social and economic achievements.

Skeptics have long doubted the long-run feasibility of reformed capitalism. In 1899, Rosa Luxemburg (1970: 43) characterized social reforms under capitalism as "a sort of a labor of Sisyphus" in which partial victories would continually be eroded by market forces. More recently, conservative critics, such as Erik Lundberg (1985), have made the reverse argument that market forces are steadily eroded by social reform with negative consequences for economic performance.

Neither view has been proven correct. Social equality and worker security have persisted in the Nordic countries, and economic growth has been on par with the US. In the US, rising inequality has gone hand in hand with social cleavages and lower welfare for at least one-third of the population. In contrast, most of Europe has experienced only a modest rise in inequality, but a sharp increase in unemployment. The Nordic countries, however, have combined social equality with good macroeconomic performance and full employment.

One reason why so many scholars nevertheless have remained skeptical may simply be that they misunderstand what the Nordic model entails. In popular debates one can distinguish between different views.

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

Nordic exceptionalism. This view insists that the Nordic model is an exception that is only feasible in small, homogeneous societies with an extraordinary commitment to equality. It emphasizes that the Nordic countries historically were homogeneous with respect to religion, language, and ethnicity. In addition, the countries had a rather egalitarian distribution of land. Social homogeneity and the small differences in initial wealth lead to more egalitarian preferences in the population than elsewhere. The logic of Nordic exceptionalism implies that the stability of the system and its achievements depend on the viability of the egalitarian preferences in the population, while more self-interest and less solidarity would undermine the system.

Capitalism without entrepreneurs. This view is often held by representatives of the political right, who claim that the Nordic model is based on too much equality, too much worker security, and too much regulation for the good of the economy. The model lacks the dynamics of entrepreneurial creativity – the essence of capitalism. The logic of capitalism without entrepreneurs implies that the stability of the system and its achievements require regulated markets. On the other hand, more markets, more globalization, and less regulation will undermine the model.

Unwarranted class collaboration. This view is often held by representatives on the political left, who claim that the labor unions misrepresent the interests of their rank and file by accepting wage moderation in central wage negotiations and by imposing restrictions on industrial actions in local wage negotiations. The logic of unwarranted class collaboration implies that the stability of pro-labor outcomes requires class struggle and not cooperation between labor and capital. More class collaboration will undermine the best features of the Nordic model.

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

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

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

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

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

Despite the claims made by supporters of the capitalism-without-entrepreneurs view, wage compression does in fact stimulate innovation, as firms with advanced new technologies do not have to pay excessive wage premiums. While wage inequality operates as though high-productivity firms were taxed and low-productivity firms were subsidized as wages adjust to local conditions, wage compression works in the opposite way: it is as though high-productivity firms were subsidized and low-productivity firms were taxed. As a result, wage equality implies that inefficient firms close down earlier as newer and more productive firms enter – contributing to the process of structural change that Schumpeter (1942) called "creative destruction."

The Nordic experience reminds us of the importance of implementation and procedures for policy outcomes. In the Nordic countries, and maybe more generally, interests may play out very differently in the labor market than in parliamentary politics. This is important, as coalition structures and economic interests in the economic base obviously affect policies chosen in its superstructure. What made the Nordic countries distinct is precisely the strength of the coalitions of ends against the middle in the labor market, which compressed the distribution of wages among workers. The wages of high-skilled middle-class workers were held back in the name of solidarity, raising profits and investments, which in turn made it possible to increase the wages of the low-paid workers without creating unemployment.

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

Recently, the Nordic model has been in the headlines in the globalization debate. Some observers have foretold the death of Nordic egalitarianism as trade becomes freer, capital mobility higher, and migration flows stronger. Michael Wallerstein and I (together with Erling Barth) took up these challenges in a small book, *Equality under Pressure,* that we wrote in Norwegian (Barth, Moene, and Wallerstein 2003).

We insisted that freer trade is not a threat to the Nordic model, since the small open economies of Scandinavia have long been used to the discipline of international competition (Finland has quite a different trade history). In all Nordic countries freer trade has in fact helped sustain institutions necessary for wage coordination. In addition, freer trade has tended to raise, not reduce, support for welfare spending to protect voters against fluctuations in the world economy.

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

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

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

If in fact the Nordic model is robust in the face of globalization, but not in the face of the internal social changes it generates, the model should not be considered an end state. Maybe the best way to look at the Nordic model of social democracy is as a productive development strategy for poor countries – as we discuss further in the final essay in this part.

It is encouraging to observe that the Nordic model is in fashion again as a source of inspiration to a number of countries. In China, the government has ambitions of building a "harmonious society" with an emphasis on redistribution, welfare, and social security. Leaders in Latin America and in South Africa refer explicitly to Scandinavia as a role model for equitable growth. It has recently been reported (*International Herald Tribune*, September 17, 2005) that "European leaders want to know how Sweden and its Nordic neighbors, so heavily laden with cradle-to-grave welfare systems, float high above the struggling economies of much of the rest of the Continent." Michael Wallerstein would have liked that.

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