

LETTLAND

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## The Nordic Model – lessons and challenges

V. DIKLI FORUM "SOCIAL MARKET ECONOMY"

To what extent have Norway succeeded in creating a welfare state that protects the needy in a way that is sustainable in the long run, and is there a lesson to learn for other countries? That is the question I will try to answer.

Many countries are facing a very challenging situation after the global financial crisis. In Europe, the level of unemployment remains at very high levels and in some cases is still on an increasing path. In some countries close to half of the young people under the age of 26 are unemployed. With severe policy constraints partly due to the euro, many countries now have limited room for manoeuvre.

The Nordic countries, on the other hand, have performed quite well over the last 15 - 20 years, showing a capacity to adapt to external shocks even in the aftermath of the financial crisis. Our countries are characterized by high levels of income and employment, and low inequality.

Let me suggest a few characteristics of the so called Nordic or Norwegian model:

- comprehensive tax - financed welfare state with generous benefits and high quality public services
- substantial public investments in human capital
- sound macroeconomic policies
- well organized employees and employers with highly coordinated wage formation

- active labour market policy and flexible labour market regulations
- exposed to competition, especially by openness to trade from abroad (open economy)

In the following I will elaborate on some of these characteristics and then go on to say a few words about the main challenges for this model and if it is exportable to other countries.

**Human capital is by far our most important national resource– not oil and gas**

To many, Norwegian welfare is associated with our oil resources, but that is misguided. Norway was a relative wealthy country in European terms already in the nineteenth century. Wages were relatively high and many Swedes, then as now, moved to Norway to work. Norwegians had one of the longest life expectancies in Europe and child mortality was relatively low. The calorie intake was high and the standard of housing was respectable. Norway had the third largest shipping fleet in the world around 1870 and we were one of the world largest exporters of fish, as well as one of Europe's largest exporters of lumber.

In the late twentieth century, Norway grew to become one of the richest countries in the world. GDP per capita is currently among the highest in the world. Large income from natural resources, such as hydroelectric power, fisheries and since the

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beginning of 1970 - ties petroleum, explains part of this rapid economic growth.

But labour is by far the largest component of our national wealth. The value of our work today and in the future amounts to 85 percent of total national wealth according to the figures. Therefore, future growth and prosperity first and foremost depend upon our ability to develop and use our human capital.

The main explanation to Norwegian wealth is to be found in the high productivity growth combined with high employment rates. How have we managed to combine economic security with high economic performance, including high labour market participation and low unemployment?

All Nordic countries have been successful in mobilising labour forces. In particular, the Nordic women have migrated into the labour market over the last 40 years. In Norway, female labour force participation increased from 50 per cent in the beginning of the 1970 - ties to 76 per cent in 2011. The unique combination of high labour force participation and high birth rates is crucial for sustaining Norway's good economic performance.

A main conclusion from this, is that family reforms, which traditionally have been regarded as pure welfare policies, also can have significant economic benefits.

It is symptomatic that the OECD – known for their hard core economic analysis, recently has pointed this out in various reports.

Ambitious welfare and family policies have been instrumental in supporting the participation of women into the labour market. All Norwegians have a statutory right to day care facilities for their children. In addition they are entitled to one year's paid parental leave – divided between the mother and father. This is one of the reasons why we maintain one of the highest fertility rates in Europe, close to 2 per cent compared to the EU average of around 1½.

The Nordic countries have fairly flexible labour markets that have proved effective in reallocating labour from declining low productivity industries to rising high productivity industries. The welfare system, combined with active labour market policies, plays an important role in facilitating this reallocation. An active labour market policy is an important tool both to smooth the labour market through business cycles and to ensure that persons on the fringe of the labour market can take part in the labour market. We have also sought to avoid rigid employment protection legislation, which might contribute to highly segmented labour markets. Taken together this has ensured an inclusive growth in Norway.

Safety nets may promote a sense of security that have made workers more open for changes in industrial structures and thus increased the economy's ability to adapt to changes. Together with an open economy, flexible labour markets and our specific production structure, this has helped us reap the benefits of globalisation.

A close tripartite cooperation may play a role to keep a well - functioning labour market, in spite of obvious interest conflicts. The origin of this cooperation is centred on our system for wage formation. Wages are set in highly centralised negotiations between a few big unions and employers. Given their size, unions have an incentive to take into account the impact of wage increases on unemployment. In order to avoid increased unemployment, overall wage growth has by and large been restricted to what export - oriented industries can pay and remain competitive.

Contrary to conventional wisdom, the Nordic experience indicates that comprehensive risk - reducing welfare systems may stimulate growth and employment. Despite a rather even income distribution, enrollment in higher education is good, and despite a tax - financed welfare state, labour participation is high. We have trade unions, relatively high taxes, and a high degree of equality (Total tax revenue in Norway is almost 43 percent of GDP, less than in Sweden, Denmark, Belgium and Italy, but well

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above the OECD average). However, our economic performance is still good.

I believe the heart of the matter is the combination policy tools, with a strong focus on dialogue with the social partners, social safety nets, open economy, gender equality which promotes family policies aiming at strengthening female participation in the labour market and substantial redistribution through an effective tax system.

### Challenges

But the model faces challenges. Some challenges we have in common with other countries, while some may be specific. An aging population, more globalized markets and a better integration of immigrants are the major ones. The overall challenge for the future is to maintain high labour force participation and high productivity to justify a high wage level. This is decisive for several reasons. First of all, it allows us broadest possible tax base. Through that we are able to finance the welfare system and public services. Secondly, high levels of labour participation imply less inactive people on public transfer schemes. Thirdly, seen from the individual perspective, having a job contributes to higher personal income, to social inclusion and to better personal health.

The share of citizens past the official retirement age to those of working age will rise rapidly in the years to come. Of course the prospect of better health and longer life is a good one. It is a product of our wealth and welfare. So are lower fertility rates. But these trends in combination pose a challenge to the welfare state and the sustainability of public finances. Similar to many other countries we have recently introduced a comprehensive reform of the public pension system to meet the future challenges. The reform will strengthen work incentives in the system.

Another specific challenge is that almost 20 per cent of the working age population in Norway is not part of working life, but recipients of health benefit. A generous sickness benefit scheme is an important part of the system.

### Is the Nordic Model Exportable?

In a survey of the Nordic countries recently, The Economist noted that Norway's relative success is not only due to our natural resources and our welfare model, but also our history and values. I think they're right. Economic growth has never been just a matter of geography, capital or competencies, but also which values people share.

It's impossible to understand the Nordic model without taking into consideration our small, ethnically homogenous populations with a high degree of trust and social cohesion. In addition, the Christian heritage has played an important part. Norway's first Christian laws around year 1000 AD were strikingly egalitarian, ensuring all newborns the right to life, ending polygamy and abolishing slavery. From the sixteenth century, Protestant confirmation classes ensured widespread literacy for both boys and girls. Protestantism encouraged people to read the Bible themselves and take a personal responsibility for their faith, cementing the idea of personal responsibility in society more generally.

Most Norwegians have long since stopped going to church every Sunday, but the Protestant ethic lives on: Solidarity, stewardship, work, personal responsibility and frugality. These values, together with trust in people to work if they can and not take advantage of the generous welfare provisions, has been, and still is, a key cultural foundation on which the Nordic model rests.

Thus, I would not venture to say that our system can be transplanted as such to other countries elsewhere. Every country has its own characteristics and history which influence what is possible and desirable.

But some elements may well be both desirable for other countries to import, such as providing free, high - quality education for the whole population, active labour market policies and flexible labour market regulations. The present challenges in international labour markets, with huge and growing youth unemployment should put such measures high on the agenda.

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To sum up, my four main points are, making them into somewhat tabloid slogans;

1) Protect and invest in the workers, don't protect jobs

2) Support production as such, don't support a specific product

3) Secure the functioning of capital markets, don't secure a specific capitalist.

4) Don't forget the family; invest in good family policies to sustain high birth rates.

Thank you for your attention.