

# THE NORDIC MODEL

LOCAL GOVERNMENT, GLOBAL COMPETITIVENESS  
IN DENMARK, SWEDEN AND FINLAND



## THE NORDIC MODEL

## READING GUIDE >>

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# Foreword

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**THE NORDIC COUNTRIES** with their extensive welfare systems as well as high competitiveness have had the world's economists scratching their heads for years. How can these countries top OECD rankings of equality between citizens and at the same time be among the world's most competitive countries? Shouldn't easy, and often free, access to benefits and services turn these Northern European citizens into welfare free-riders resulting in inefficiency and low competitiveness? No, actually quite the opposite is the case if you look at global comparisons or ask renowned scholars in the region.

The Nordic paradox of welfare and competitiveness is just one of the issues we at KommuneKredit, MuniFin and Kommuninvest often discuss at meetings and presentations. As local government funding agencies in Denmark, Finland and Sweden, we supply local governments with credit for investments, which is made possible by the joint liability of all our members. Therefore our success is dependent on our ability to make the so-called Nordic Model comprehensible to our many stakeholders and investors around the world.

We have asked the Scandinavian think tank Monday Morning to help us tell more of the story about the Nordic

Model and give a reader-friendly introduction to the role of the municipalities and local governments in the three countries: What characterises the economies and the institutional set-up in the Nordic countries? How are they different from other countries? And what do these differences entail?

By answering some of these questions about the welfare states of Denmark, Finland and Sweden, we want to portray a region that is attractive to investors from all over the world.

This report consists of a series of journalistically edited stories on how the Nordic Model is realised in Denmark, Finland and Sweden. The content is based on solid input and well-established knowledge from scholars, international institutions and respected journals. The sources of the most important information and conclusions are included for your service and perusal. It is directed to you as a high-level government official, central bank executive, institutional investor or investment manager dealing with or investing in Denmark, Finland and Sweden. It is an introduction to a unique system.

Enjoy the read and welcome to the Nordic Model.




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Country facts and economic fundamentals

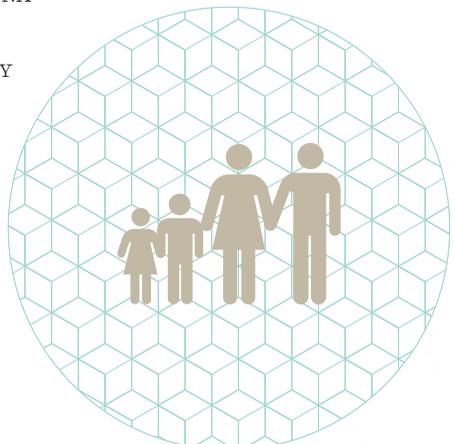


**DENMARK**

- CAPITAL**  
**COPENHAGEN**  
1,2 MILLION
- POPULATION**  
5,6 MILLION
- FORM OF GOVERNMENT**  
CONSTITUTIONAL MONARCHY
- LANGUAGE**  
DANISH
- SIZE**  
43,094 SQ KM / 16,639 SQ MI
- CURRENCY**  
DKK - DANISH KRONE
- EU MEMBER SINCE**  
1973, 1ST OF JANUARY

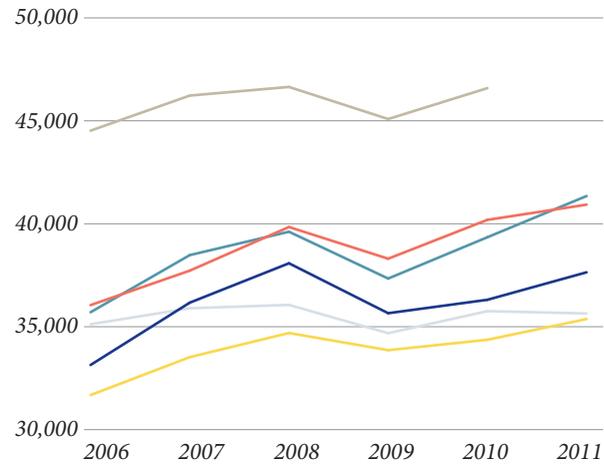
- POPULATION**  
9,5 MILLION
- FORM OF GOVERNMENT**  
CONSTITUTIONAL MONARCHY
- OFFICIAL LANGUAGE**  
SWEDISH
- SIZE**  
449,964 SQ KM / 173,745 SQ MI
- CURRENCY**  
SEK - SWEDISH KRONA
- EU MEMBER SINCE**  
1995, 1ST OF JANUARY

- CAPITAL**  
**HELSINKI**  
1,1 MILLION
- POPULATION**  
5,4 MILLION
- FORM OF GOVERNMENT**  
REPUBLIC
- OFFICIAL LANGUAGES**  
FINNISH (90%)  
SWEDISH (5%)
- SIZE**  
338,424 SQ KM  
/ 130,596 SQ MI
- CURRENCY**  
EUR - EURO
- EU MEMBER SINCE**  
1995, 1ST OF JANUARY



## DEVELOPED ECONOMIES

GDP PER CAPITA, CURRENT US\$, PPP

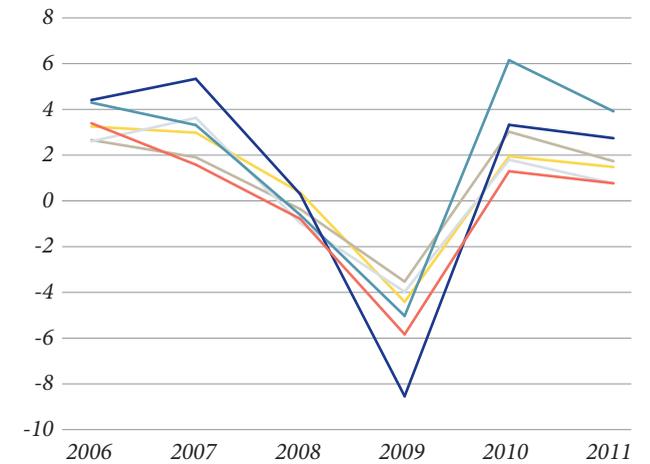


Source — OECD

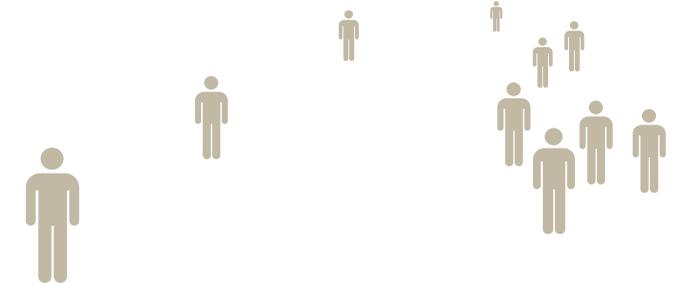
- DENMARK
- SWEDEN
- FINLAND
- UNITED KINGDOM
- EURO AREA
- UNITED STATES

## RESUMED GROWTH

GDP GROWTH RATES, PERCENT

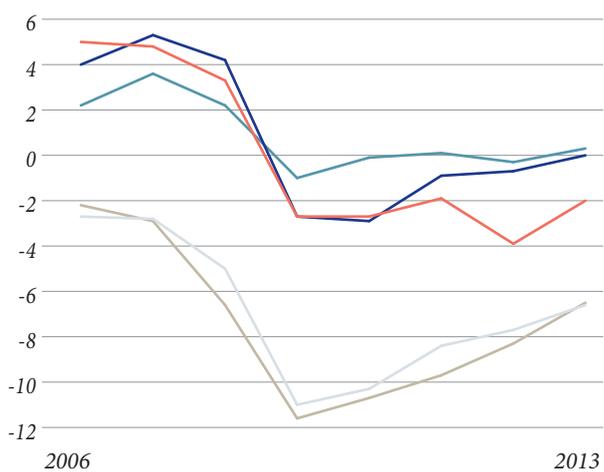


Source — OECD



## BALANCED GOVERNMENT BUDGETS

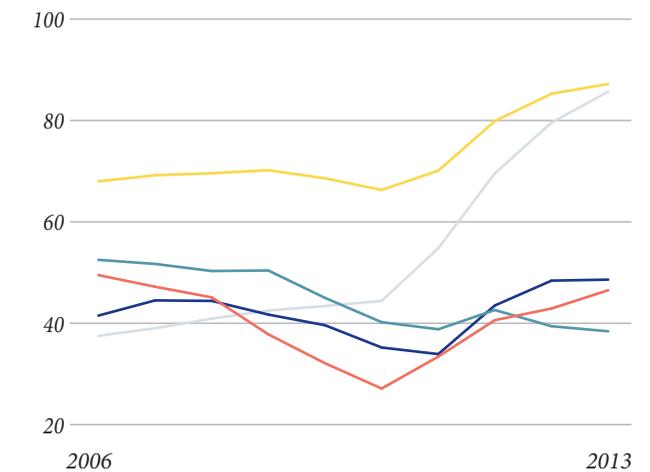
NET LENDING/NET BORROWING AS A PERCENTAGE OF GDP



Source — OECD 2012

## RELATIVELY LOW DEBT

TOTAL CENTRAL GOVERNMENT DEBT AS PERCENTAGE OF GDP



Source — OECD

# LOCAL GOVERNMENT, GLOBAL COMPETITIVENESS

Over time, through numerous reforms, Denmark, Finland and Sweden have developed very similar and highly successful models of governance and welfare. As a whole, we call it the Nordic Model.



POLIFOTO

## LOCAL GOVERNMENT: CORNERSTONES IN THE NORDIC SOCIETIES

The Nordic countries have decentralised the decision-making and deliverance of welfare services, in order to secure the effectiveness and flexibility of the public sector. The local governments in the three countries collect and spend a higher proportion of the total government revenue than in other developed countries, and they have a constitutionally guaranteed autonomy with the right to levy taxes. The local government, however, is not free to fail. It is tested legal practice in all three countries that local governments cannot go into bankruptcy.

The local Nordic governments provide a wide range of services to their citizens. The tasks include primary education, child care and preschool, care for the elderly, and many other.

To perform all these tasks the local government institutions need to be of a certain size. Nordic municipalities in general have more inhabitants than municipalities in other countries. They are run by councils which are democratically elected by local voters. Participation in local elections is high and all three countries receive top global ratings when it comes to low levels of corruption, high levels of trust and government effectiveness.

## THE NORDIC BALANCE: HIGH TAXES, HIGH SOCIAL SERVICE LEVELS

Denmark, Finland and Sweden have some of the highest taxation levels in the world. However, citizens accept this because they are satisfied with the wide range of services that they receive in return. Taxes pay for some or all of the costs associated with education, health care, care for the elderly and many other social services – services that citizens in other countries pay for out of their pockets or through insurance.

The Nordic Model is neither more expensive nor less efficient than other OECD countries' systems. The three countries spend a smaller proportion of GDP on social services than the United States, Germany or France.

Taxes are deducted by employers before paying wages and collected through effective digital systems. The money is administered by some of the most effective government systems in the world. Nordic citizens are willing to pay substantial taxes only so long as they are confident that the money will be used effectively to deliver high-quality services.

Public funds are being invested in lifelong learning and generous unemployment benefits. This system is called the flexicurity model. It allows Nordic companies to be more flexible in their planning, which underpins the countries' competitiveness.

## DEVELOPING THE NORDIC MODEL: COOPERATION AND COMPROMISE

The Nordic Model does not build on a blueprint or grand design, but has evolved gradually through continuous reforms. For more than a century parties from both sides of the political spectrum and a large number of different organisations from the Nordic societies have contributed to the development of the model. This demonstrates the high level of public consensus and support that underpins the Nordic Model. That the Nordic Model should stand is not an issue.

The Nordic countries benefit from a stable political environment where broad compromises ensure that a shift in governmental power does not mean a major shift in policies. This tradition for broad negotiations and cross-bloc alliances is even more pronounced in the local governments, where pragmatism often trumps ideological differences.

The Nordic countries have an impressive history of innovation – not only by its businesses. The labour market has developed efficient models to approach full employment of the work force, while social innovation has made the Nordic countries world champions in social mobility.

## THE FUTURE OF THE MODEL: FACING CHALLENGES, STAYING COMPETITIVE

Continuous reforms through history have adapted the model to meet various challenges. Nowadays the Nordic countries face demographic changes that can cause a future shortage of labour. However, more children are being born in the Nordic region than in many other countries.

According to renowned economists, another major challenge is how to maintain productivity growth so that the countries remain competitive in the global marketplace. Due to less impressive results in recent years this is an important political priority in all three countries.

These challenges need to be met to ensure long-term stability and sustainability for the Nordic Model and its local governments. It is worth noting that the Nordic countries have, until now, weathered the current crisis quite successfully. Ongoing reforms of the labour market and pension schemes as well as successful control of public spending and debt levels provide the three countries with a solid foundation for dealing with the described challenges. This is a continuation of the three countries' recent track records, which are a testament to their willingness to make tough economic decisions in order to ensure the viability of the Nordic Model.

Many famous cultural and historical figures hail from the Nordic countries. You probably already know aspects of the Nordic societies and their culture – maybe without realising it.



## SOCIETY

**CLEAN ENERGY** – All the Nordic countries give high priority to renewable energy, and are among the leading nations of the world when it comes to exporting clean technology.

**ROYAL FAMILIES** – The Danish monarchy is almost 1000 years old, and both the Danish and the Swedish royal families are still highly popular.

**SOCIAL WELFARE** – The Nordic countries have some of the smallest gaps between rich and poor in the world.

**BICYCLES** – 55 percent of all Copenhageners commute daily by bike.

## COMPANIES

**VOLVO** – Volvo means ‘I roll’ in Latin. The Gothenburg based company primarily produces trucks and buses.

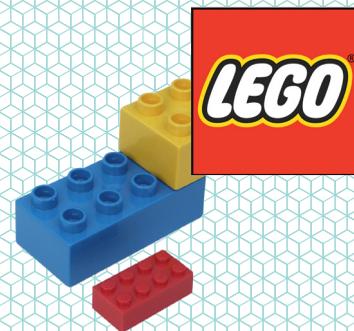
**IKEA** – Founded in Sweden in 1943 by 17-year-old Ingvar Kamprad. Today it is the world’s largest furniture retailer, and Kamprad is one of the richest people in the world.

**H&M** – With over 2,300 stores in 43 countries this Swedish company is the world’s second largest clothing retailer.

**LEGO** – Based in Billund, Denmark, LEGO has always been family owned. They also own and run the Legoland theme-parks.

**NOKIA** – 22,5 percent of all mobile phones come from this Finnish company, making Nokia the world’s second largest manufacturer.

**CARLSBERG** – Founded in Copenhagen in 1847, Carlsberg is now the world’s fourth largest brewery group, with over 500 brands, including Tuborg, Baltika and Kronenbourg 1664.



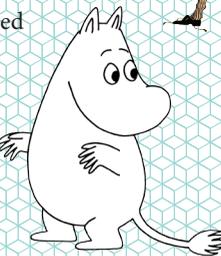
## CULTURE

**VIKINGS** – The Vikings roamed the seas of the Nordic hemisphere from the late 8th to the mid-11th century, and traded with most parts of Europe.

**H.C. ANDERSEN** – The Danish author lived from 1805 to 1875. He wrote The Little Mermaid, The Ugly Duckling and many other fairytales.

**PIPPI LONGSTOCKING** – The Swedish children’s book author Astrid Lindgren is the world’s 18th most translated author, and has sold nearly 150 million copies.

**THE MOOMINS** – The first story about the Finnish trolls was published in 1945 by Tove Janson.

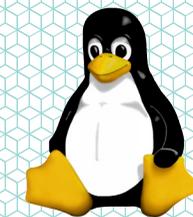


## SPORTS

**BJÖRN BORG** – Borg is a legendary tennis star. He won 11 Grand Slam titles, including five consecutive Wimbledon titles.

**MICHAEL LAUDRUP** – A Danish footballer who won 5 straight La Liga titles with Barcelona and Real Madrid.

**MIKA HÄKKINEN** – Finnish racing driver and two-time Formula One World Champion.



## DESIGN

**ALVAR AALTO** – Aalto is a modernist Finnish architect and designer, especially famed for his chairs and glassworks.

**ARNE JACOBSEN** – One of the fathers of Nordic design. Among many other things he designed the famous egg chair.



## COMPUTING

**SKYPE** – Danish-Swedish developed computer program, with almost 700 million registered users.

**ANGRY BIRDS** – This Finnish computer game has been downloaded more than 1 billion times in total.

**LINUX** – Finnish developed computer operating system. Based on 100 percent free open source software.

**SPOTIFY** – Swedish music streaming service, allowing users to choose from an extensive music library.



# THE NORDIC MODEL

## – Stable and sustainable



What sets the Nordic model apart? And how do the countries keep their tax-financed public sectors efficient and their economies competitive?

The Nordic model combines some of the highest tax levels in the world with high levels of competitiveness and a strong tradition for accountability and efficiency. The model has evolved over time through a long series of reforms and is based on basic rights to tax financed public services for all citizens. Historically it has demonstrated its ability to meet the challenges of globalisation.

In the Nordic model much of the decision-making and service-providing is done by local governments. The local governments have the right to levy taxes and constitutionally guaranteed autonomy. They are governed through local democracy, which makes them highly accountable to their citizens.

### LOCAL GOVERNMENT: CORNERSTONES IN THE NORDIC SOCIETIES

The local governments in Denmark, Finland and Sweden levy and spend a proportionally bigger part of the government revenue than in other developed countries. See figure 1.

In all three countries, the autonomy of local governments,

and their right to levy taxes, is constitutionally protected. Local governments are granted wide-ranging freedom, but they are not free to go into bankruptcy. This condition has been settled by the courts in each of the countries.

The central government handles departments such as the police, military, laws and courts. Most other welfare services are provided by the local governments, including social services, care for the elderly, child care, preschool and primary education.

The Nordic municipalities are large compared to most other developed countries. The average number of inhabitants in a Danish municipality is 56,590, Swedish municipalities have 32,478 inhabitants on average, and the average size of Finnish municipalities is 16,006 inhabitants. Reforms have merged smaller municipalities in Sweden and Denmark in the search for the right balance between the advantages of economics of scale and the proximity offered by local units.

This proximity of decision power makes the local decision makers accountable to the voters, with high participation in local elections in all three countries. It

### MUNICIPALITIES HANDLE THE MONEY

Share of public expenditure spent by local government.

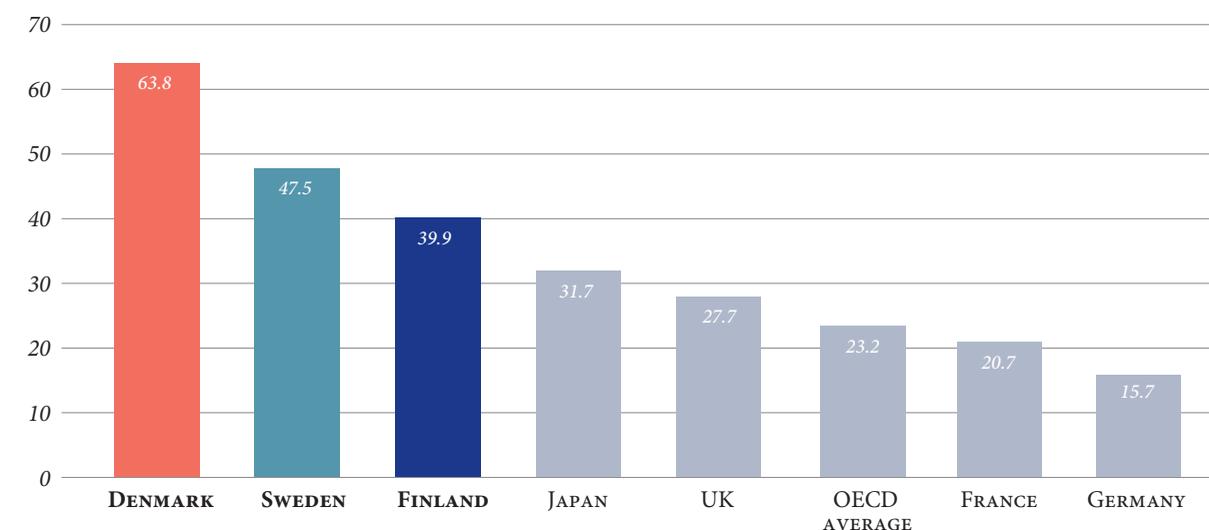


FIGURE 1 The Nordic municipality, with its extensive portfolio of tasks, is responsible for a higher proportion of government spending than in other countries.

Source — OECD (2011): Government at a Glance 2011.

also supplies local knowledge and a focus on pragmatic solutions to those who make the everyday decisions. Because the local governments levy taxes to pay for the services, the decision makers have a strong incentive to use tax revenues efficiently.

Local flexibility is encouraged by the fact that the local governments are largely free to decide how to deliver welfare services to the citizens. This decentralised structure has proven very efficient. All three countries get top global ratings when it comes to low levels of corruption, high levels of trust and government effectiveness.

### THE NORDIC BALANCE: HIGH TAXES, HIGH SOCIAL SERVICE LEVELS

The Nordic countries rely heavily on taxes to pay for their social services. As a consequence Denmark and Sweden are at the top of the OECD chart for total tax revenue as a percentage of GDP and Finland does not trail far behind. See figure 2.

Citizens in the three countries are not unhappy with the high tax levels. Research shows they are willing to pay high

taxes if they feel they get their money's worth.

And it seems they do: Denmark, Finland and Sweden can boast examples of some of the best governance in Europe. According to a large study by the University of Gothenburg for the European Commission, Denmark, Sweden and Finland are ranked 1, 2 and 3 in the EU when it comes to value for tax money. And the citizens in Denmark, Finland and Sweden are generally very satisfied with the social services they receive. Surveys among parents with children in day care or primary school, patients in hospitals, elderly citizens receiving care and other recipients of public services in the three countries reveal high levels of satisfaction with the services provided.

The tax systems in the three countries are digitalised and highly efficient. Tax is deducted at the source, meaning that employers withhold tax and pay it on behalf of their employees every month. This makes tax evasion very difficult.

Furthermore, the system is designed to lessen the negative impact on competitiveness. In fact, scholars argue that the economic policies financed through the

### HIGH TAX LEVELS

Total tax revenue as percentage of GDP.

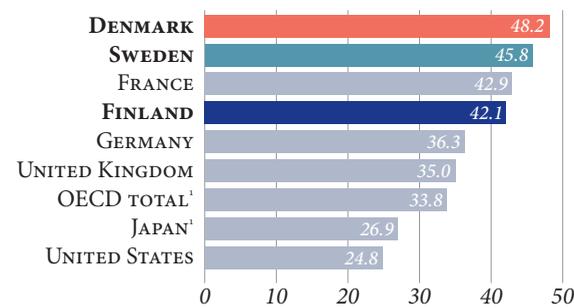


FIGURE 2 Denmark and Sweden have the highest share of tax revenues compared to GDP. Finland does not trail by much.

Note: 2009 figures.  
Source – OECD, 2010.

### FLEXIBLE WORKFORCE

Labour turnover rate (hiring and firing), percentage of employment, 2010

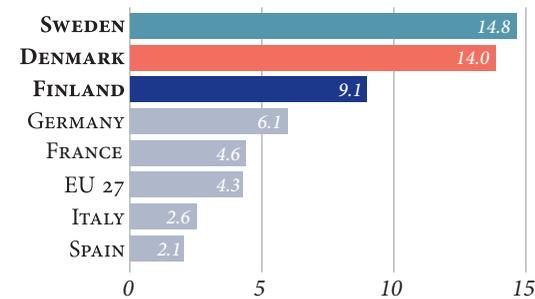


FIGURE 3 A larger proportion of Danes, Finns and Swedes change jobs than their fellow Europeans. This flexibility is encouraged through generous benefits and allows companies as well as workers to act in a more flexible way in the market.

Source – Eurostat.



“(...) generous unemployment benefits and retraining schemes result in a high labour turnover rate. This enables companies to be more flexible in their planning.”

### THE NORDIC MODEL IS INEXPENSIVE

Gross and net social spending in selected countries, percentage of GDP, 2007

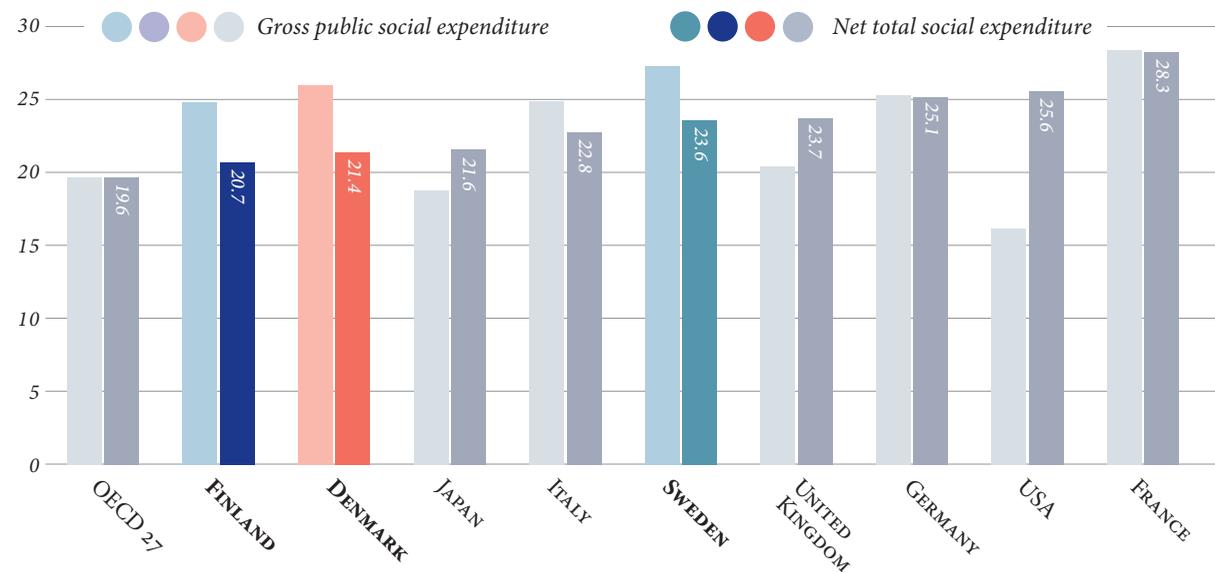


FIGURE 4 The welfare system in the three Nordic countries is not expensive by international comparison. Net total social expenditure designates the share of GDP spent on social services through private and public payments.

Source – OECD (2011): “Is the European welfare state really more expensive?”.

taxes strengthen the competitiveness of Nordic companies. A good example is that generous unemployment and retraining schemes result in a high labour turnover rate. This enables companies to be more flexible in their planning. See figure 3.

When one takes a closer look at the welfare systems in the three countries, it becomes clear that the Nordic Model is not expensive by international comparison. Social spending levels are similar in countries often thought to have very different public social expenditure levels, such as France or the United States. OECD finds that Finland spends only 20.7 percent of its GDP on social expenditure, with Denmark and Sweden spending only a little more. By comparison the United States spends 25.6 percent of its GDP on social expenditure and France tops the list of the 31 OECD countries with an expenditure of 28.3 percent. See figure 4.

#### DEVELOPING THE NORDIC MODEL: COOPERATION AND COMPROMISE

The Nordic Model is not the product of a single blueprint or a grand design. It has been constructed step-by-step over more than a century through a series of reforms involving parties from both sides of the political spectrum. For this reason there is a general consensus among decision makers and the people of Denmark, Finland and Sweden that the Nordic Model should be maintained.

This is not a point of contention in the public debate. Instead the debate focuses on how the Nordic model should be managed, organised and developed. “Develop to maintain” sums up the approach of the countries’ politicians, economists, labour market organisations and engaged citizens.

The parliamentary systems in the Nordic countries promote representation of multiple parties. Central governments in all three countries are often based on a coalition, and very often governments in Denmark and Sweden are minority governments in need of support from opposition parties. This system favours broad negotiations and consensus-seeking both among coalition partners in the cabinet and between the government and opposition.

Historically this has helped to ensure stability and continuity within the political system. With cross-political ownership of the political agreements, a shift in governmental power does not mean a total shift in policies. This has resulted in a relatively stable political environment with many political agreements respected from one government to another.

The tradition for broad negotiations and cross-bloc alliances is even more prominent at the local level. Elected councils run local governments and parties normally cooperate to form a majority behind the choice of mayor. Cooperation on the local level is often pragmatic and solution-oriented and often spans both right and left-wing parties.

Nordic welfare policies have been persistently developed. A large number of different organisations, actors and individuals have committed themselves to the innovation of the Nordic Model. The ongoing development has revolved around:

- **LABOUR MARKET INNOVATION:** The Nordic Model has engaged labour market organisations in sustainable policies. They have helped to develop work-based education schemes and a high level of shared responsibility. >

“High levels of economic redistribution have made the Nordic societies the most equal and socially mobile in the world.”



Levels of conflict have been low and the labour market is both flexible and secure, known as ‘flexicurity’. The labour market organisations play an important role in programmes for further education and training, which is possible because a large share of workers are organised in labour organisations.

● **SOCIAL INNOVATION:** High levels of economic redistribution have made the Nordic societies the most equal and socially mobile in the world. Day care and professional care for the elderly have enabled more women to actively participate in the labour market while securing equal opportunities for citizens. Unlike a number of other developed countries, families are still having children, even with both parents working, keeping the reproduction rate in the Nordic countries among the highest in Europe. The Nordic average of 1.9 babies per woman is higher than the euro region average of 1.6.

● **BUSINESS INNOVATION:** Creating an innovative environment with investments in research and development and freeing business of unnecessary bureaucracy has been high on the agenda of the central and local governments – most often across political dividing lines. This focus on competitiveness seems to have paid off: The Nordic economies are all highly competitive, and have been ranked by the World Economic Forum to be among the most competitive economies in the world since the early

2000s. In 2012 Finland was placed 3rd, Sweden 4th and Denmark 12th out of the 141 countries surveyed.

Business innovation is essential to the Nordic business community. The Nordic countries are small, open economies with extensive trade relations with foreign countries. It is against this background the Nordic Model has been developed. Studies point out that the high levels of competitiveness have partly originated from the unique institutions in the Nordic Model, such as free high quality education systems, a focus on social mobility, well-established labour market institutions, child care and care for the elderly. These elements combined allow a large proportion of the population to be part of the labour market.

**THE FUTURE OF THE NORDIC MODEL: FACING CHALLENGES, STAYING COMPETITIVE**

The Nordic Model has proved its success in recent decades. But this cannot be taken for granted in the years to come. History shows that continuous reforms have always been a necessary part of the Nordic Model. Leading economists point out that this is more than ever the case in the current situation of economic crisis and turmoil.

Like most western countries, Denmark, Finland and Sweden are affected by the financial crisis. The crisis poses a serious challenge to the foundation of the Nordic Model with its large public sector and high levels of redistribution. Along with the current challenges created by the financial

**THE DEVELOPED WORLD IS GROWING OLD**

Elderly population (aged 65 and over) as a percentage of total population.

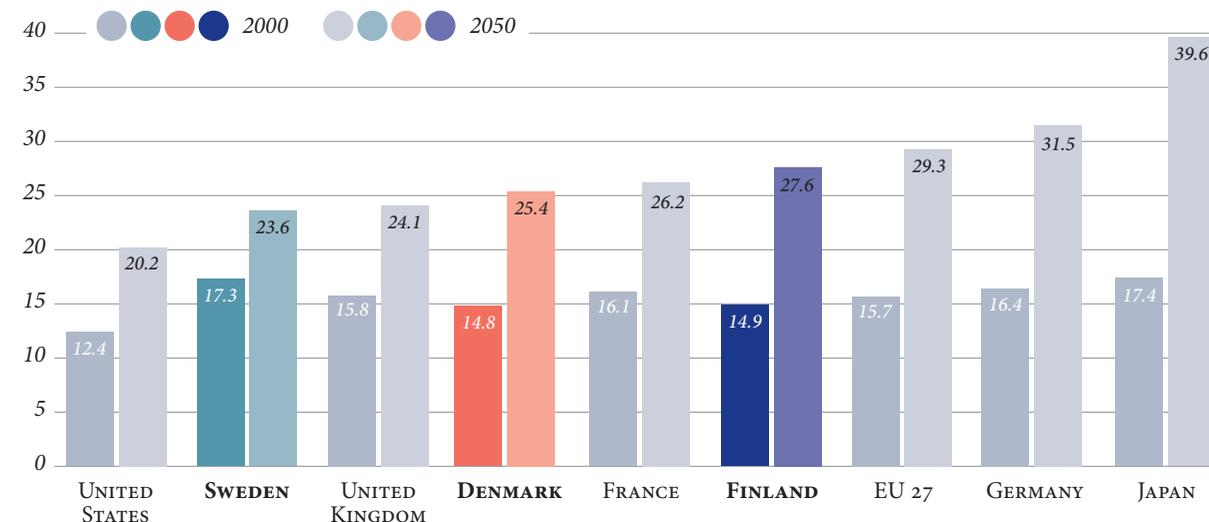


FIGURE 5 The world is getting older, but less so in Denmark, Finland and Sweden than in other countries. Source — OECD Factbook 2010: Economic, Environmental and Social Statistics.

crisis, including high unemployment levels, the three countries face the same long-term challenges as other developed countries. Ageing populations mean that more Nordic citizens will retire from the workforce and require pensions and care. See figure 5.

Declining fertility ratios also mean smaller workforces to provide for the elderly. This increases the dependency ratio and put strains on public finances in the three countries. In order to ensure the competitiveness of the model in the global economy these challenges must be addressed.

The good news is that the three countries have a solid foundation for dealing with challenges. A long history of economic reforms means that the current challenges are manageable. Substantial labour market and pension reforms have already been made or are under way. Furthermore the financial discipline of the three countries has enabled them to control public spending and debt levels, with their government debts being among the lowest of the OECD countries’. The governments in Finland and Denmark had relatively low deficits in the 2008-2010 crisis period, and Sweden even achieved small surpluses. See figure 6.

The Nordic Model is deeply rooted in the history and culture of Denmark, Finland and Sweden, as well as in their decentralised political structures. The model enjoys wide public and political support, and the track records of the three countries prove that they are all capable of making the necessary structural changes in order to ensure economic sustainability.

**BALANCED BUDGETS**

Net lending/net borrowing as a percentage of GDP, surplus (+), deficit (-)

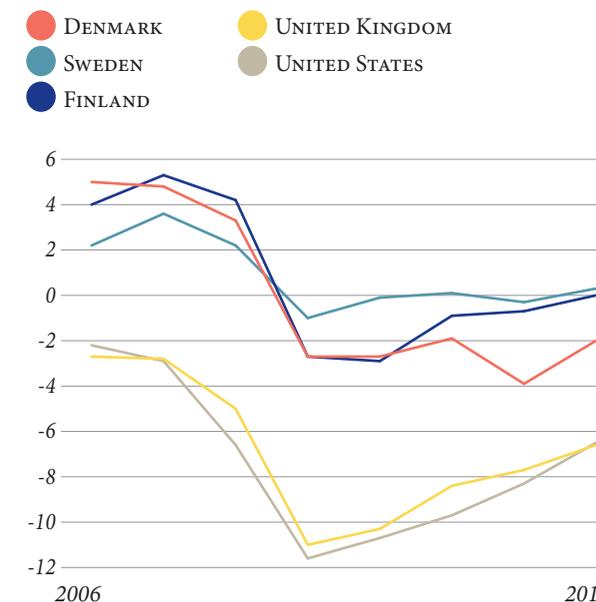


FIGURE 6 The lending and borrowing is under control. The estimate is that the countries will improve their balance further. Source — OECD 2012

Denmark, Finland and Sweden all have three democratic levels with different responsibilities: A national, a regional and a local level. All three handle important tasks in the everyday lives of citizens.

	TASKS	DENMARK	FINLAND	SWEDEN
<b>NATIONAL LEVEL</b>	Police, military and overall policy.	179 members of parliament	200 members of parliament	349 members of parliament
<b>REGIONAL LEVEL</b>	Health care and regional development.	5 regions	18 regions (+ the Åland islands)	20 regions
<b>LOCAL LEVEL</b>	Primary education, social services, care for the elderly, child care and preschool, waste handling and environmental protection, water supply, libraries, sports facilities, city planning and zoning.	98 municipalities	336 municipalities	290 municipalities

Source — Swedish Association of Local Authorities and Regions, Local Government Denmark, Danish Ministry of Finance, Danish Regions, the Association of Finnish Local and Regional Authorities

### THE MUNICIPALITY IS RUN BY LOCAL POLITICIANS...

The municipalities are run by a council of elected politicians led by the mayor. The mayor is elected for a fixed four-year period and neither the majority, nor the mayor will normally change in an election period. Generally there is a rather high turnover rate with four or five out of ten councillors being newcomers after each election. Therefore the municipal councils are a guarantee for a high degree of local knowledge among the decision makers.

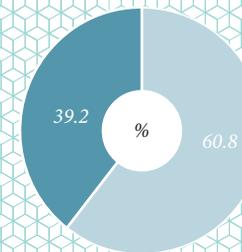
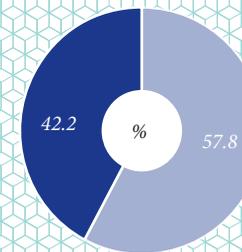
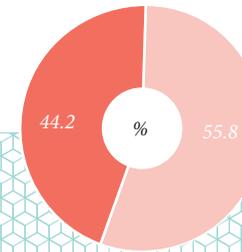
### AND SUPPORTED BY STRONG ADMINISTRATIONS...

The political organisations is supported by a strong administrative organisations. The board of managers normally consists of experienced public servants and it is not unusual that municipal managers get high-level jobs in the ministries or in the private sector. At the executing level the municipal work force consists of professionals like teachers, nurses and social workers. And lots of them. Finnish municipalities employ 420,000 persons, Swedish municipalities employ around 760,000 persons and Danish municipalities employ some 505,000 persons.

### MANY COUNCIL MEMBERS ARE REPLACED PERIODICALLY

Newly elected versus re-elected members in the Nordic local councils

● Newly elected ● Re-elected

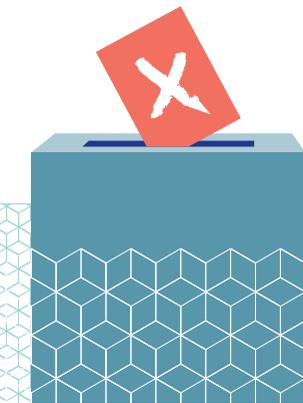


Close to half of the municipal council members are newly elected, ensuring a strong connection with the local community.

Source — Local Government Denmark, Statistics Finland and Statistics Sweden.

### THE MAYORS ARE FULL-TIMERS...

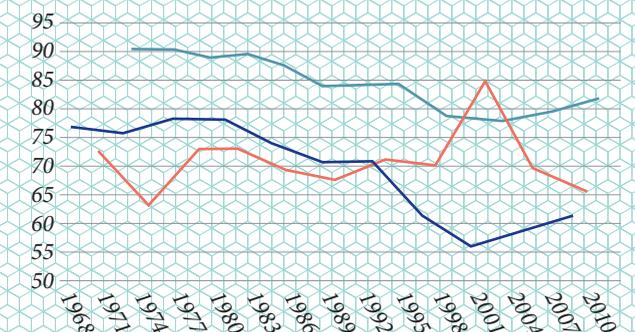
Citizens aged 18 years and older are entitled to vote and may stand for election. Most of municipal board members at both local and regional level have jobs alongside their political engagement. However, the mayors are employed full-time to give them time to deal with the many decisions involved in running a organisation of this size. The municipal councils are organised in specialised committees and the seats of the committees are divided between the political parties according to election results.



### HIGH VOTER TURNOUT

Voter turnout for elections for Nordic municipal councils, percentage of people with suffrage rights

● DENMARK ● FINLAND ● SWEDEN



A large proportion of the population vote in municipal elections in the Nordic countries.

Source — Statistics Sweden, Statistics Finland, Local Government Denmark.

### THE VOTERS ARE DEDICATED...

The election turnouts in Denmark, Finland and Sweden are higher than in most other countries. On average 78 percent of Swedish voters, 70 percent of Danes and 56 percent of Finns turn up at local elections every four years. The voter turnout at the national level is somewhat higher and comparative participation numbers indicate that the citizens are still more interested in casting votes on a national level. However, the many issues of great importance for the individual citizen decided in the local government encourage the citizens to assert their influence through local elections.

# LOCAL GOVERNMENT

## - Cornerstones in the Nordic societies

What is the role of the local government? Which tasks does it handle, and how do the Nordic countries ensure efficiency and accountability?



The Nordic Model is often labelled as a welfare state. It is better depicted as a city or a town. Welfare services in the Nordic countries are not provided by a central government monopoly that doles out benefits to its citizens or provides services from a central administration. It is built upon the principle that political decisions should be made and social services should be delivered as close to the citizen as possible. The local governments are therefore the main welfare providers, ensuring that centrally mandated services are delivered as efficiently as possible.

The local governments in Denmark, Finland and Sweden differ from those in other countries in several aspects. Key differences include:

- **LOCAL SPENDING:** Local governments in the three countries levy and spend a proportionally larger part of government revenue than in other developed countries.
- **CONSTITUTIONALLY GUARANTEED:** Local governments in the three countries have a constitutionally guaranteed autonomy and right to levy taxes.
- **MANY TASKS:** Nordic local governments provide a wide range of services to their citizens. In other countries many of these tasks are handled by the central government or

private companies, by local organisations or in the family.

- **HIGH ACCOUNTABILITY:** Local democracy and proximity to the citizens are key features in the local government structures of the three countries. All three countries top global ratings when it comes to low levels of corruption, high levels of trust and high levels of government effectiveness.

### LOCAL SPENDING

Public spending in the Nordic countries is managed very close to where the need is. This makes the local government a key financial unit in the Nordic Model. Local governments in Denmark, Finland and Sweden account for substantial shares of public spending and also levy substantial shares of the taxes.

Local governments in the three Nordic countries spend a substantially larger share of government revenue than they do in other developed countries. Between 39.9 and 63.8 percent of public expenditures in Denmark, Finland and Sweden are handled by local governments, compared to an OECD average of 23.2 percent. *See figure 1.*

The local governments are entitled to levy taxes and thereby raise a major part of the funding for welfare

### MUNICIPALITIES HANDLE THE MONEY

Share of public expenditure spent by local government.

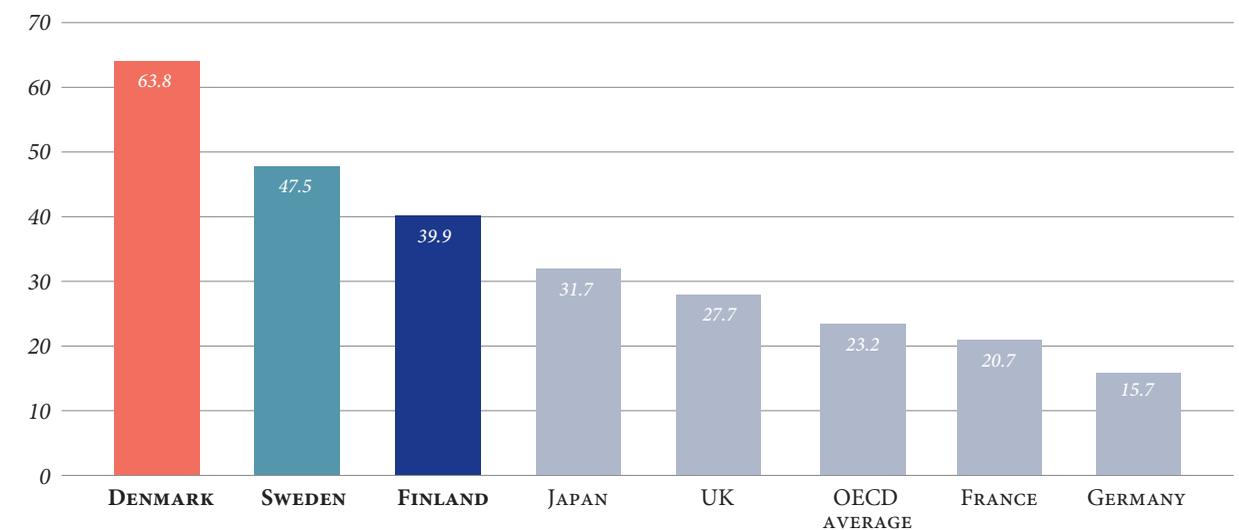


FIGURE 1 The Nordic municipality, with its extensive portfolio of tasks, is responsible for a higher proportion of government spending than in other countries.

Source — OECD (2011): Government at a Glance 2011.

services. In Denmark, Finland and Sweden between 28 and 38 percent of taxes and other public revenues are levied by local governments, compared to an OECD average of 14.9 percent. *See figure 2.*

Two significant advantages lie with the local governments' right to levy taxes. The first advantage is that a local government can raise taxes if it needs additional funds. Agreements between local governments and the central government outline the latitude of this option. The second advantage is discipline. Decision-makers in the local governments need to consider their spending because they are the ones who have to defend future tax increases to their voters, which discourages imprudent spending.

The exact combination of revenue streams varies between the countries, but in all three the majority of local government tax revenue stems from income taxation. The remainder of local government revenue comes from a mix of state grants, user charges to citizens, businesses and other sources. *See figure 3.*

Tax rates between the different local governments in the countries vary because of the local flexibility in levying taxes. Furthermore, tax bases vary between local governments due to differences in the makeup of their

populations and business communities. These differences could threaten to undermine the legal principle of equality of services provided to the citizens. That is why all three countries have developed intricate systems of financial redistribution from wealthy to less wealthy municipalities. This mechanism is set in place to provide all local governments with the funding needed to provide basic required services. These systems of equalisation are negotiated between the central and the local government. However, the redistributions to the less wealthy municipalities are not paid for by the state, but handed over from the wealthy municipalities. The objective is to ensure that the citizens in municipalities with lower tax bases do not experience too great a difference from those living in affluent municipalities.

### CONSTITUTIONALLY GUARANTEED

Local authority to tax is constitutionally guaranteed in Denmark, Finland and Sweden. In the long history of decentralised government, the local government has been granted autonomy to develop new ways of providing services to the citizens. For example, Finnish local governments cooperate with each other as an integral part

BOX 1

THE NORDIC LOCAL GOVERNMENTS ARE TOO IMPORTANT TO FAIL

THE CENTRAL ROLE OF MUNICIPALITIES in the societies of Denmark, Finland and Sweden is underlined by the fact that they cannot go into bankruptcy. It is simply a legal impossibility for Nordic municipalities. In contrast, 5.5 percent of US municipal bonds defaulted in 2010 and 2011. This has never happened in the Danish, Swedish and Finnish municipalities' over 100-year long histories.

It is not that the municipalities in the three countries have not had financial problems. Some of them have. And all three local government sectors hold examples of municipalities that through the years have had difficulties paying back their debts.

In the 1980s a case regarding a municipality in Denmark was tried in the Danish legal system. This resulted in a verdict stating that Danish municipalities cannot go into bankruptcy.

In southern Finland the municipality of Karkkila came

into great financial difficulty in 1992 due to an increase in incurred debt, but it did not go bankrupt. Instead the problems were resolved through emergency legislations on a national level and by increasing municipal taxes to the highest level in the country. The Finnish government has since established specific procedures related to municipalities in financial distress.

In southeastern Sweden in the 1990s, a citizen wanted the municipality of Hultsfred to be declared bankrupt, but the Swedish courts ruled that the national laws did not warrant municipal bankruptcies.

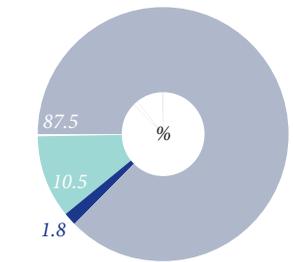
Interestingly, the absence of bankruptcy as an option for municipalities has not contested the high levels of accountability and good governance in any of the countries. The risk of being put under administration by the central government is seen as a serious intervention that is to be avoided at all costs.

*“It is a guiding principle that tasks should be planned and performed as close to the citizens as possible, while not giving up on the advantages of economics of scale.”*

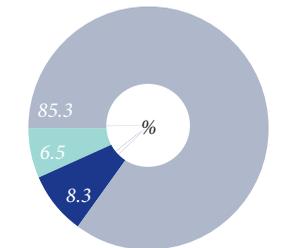
WHERE THE MONEY COMES FROM

Sources of municipal taxes, percent.

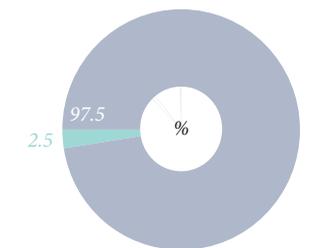
Income tax Corporate tax Property tax



DENMARK



FINLAND



SWEDEN

FIGURE 3 Sources of municipal taxation revenue. The vast majority of tax to local government is stædet for municipal taxation revenue comes from income tax. Municipalities have the right to levy taxes in order to finance their activities.

Source — Local Government Denmark, The Association of Finnish Local and Regional Authorities and Swedish Association of Local Authorities and Regions

LOCAL GOVERNMENT LEVIES TAXES

Share of public revenue levied by local government

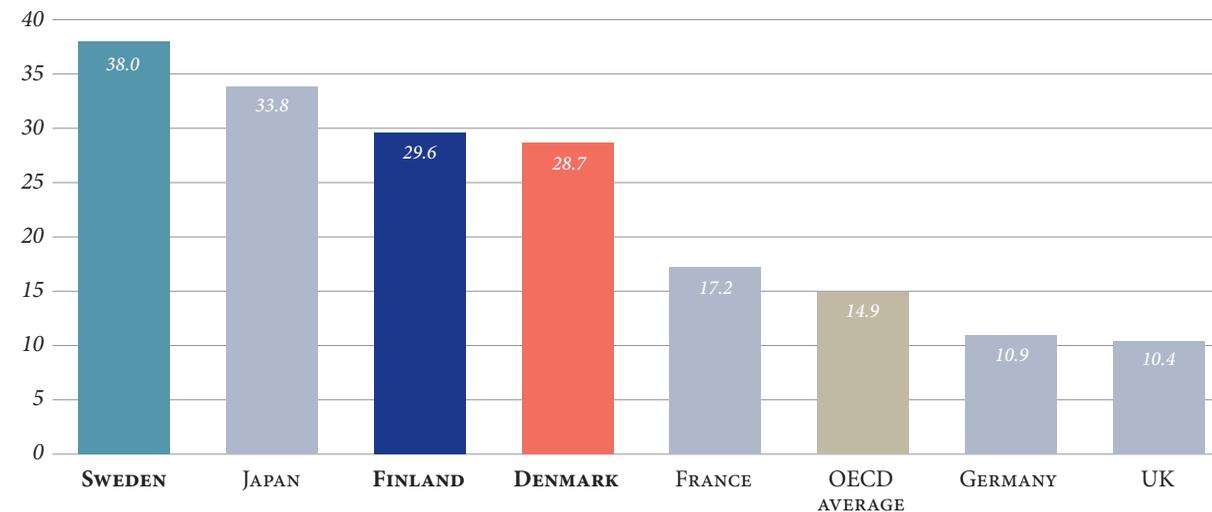


FIGURE 2 Local government levies a higher share of public revenue than in other countries.

Source — OECD (2011): Government at a Glance 2011.

of their service delivery and Danish local governments have a strong tradition of using independent, but wholly-owned, subsidiaries to provide services.

Freedoms are manifold. However, the local government is not free to fail. If one local government should end up in financial trouble that cannot be handled within the tax system in the individual municipality or the system of equalisation, it does not lead to bankruptcy. It is tested legal practice in Denmark and Sweden that a municipality cannot go into bankruptcy, and in Finland it is stated in the Act of Bankruptcy that a Finnish Municipality cannot go into bankruptcy. See box 1.

The Nordic local governments' right to self-governance dates back to at least the 1800s, building on the earlier tradition of strong parish councils, and are secured in the Danish, Finnish and Swedish constitutions. See box 2.

The decentralised administrations in the Nordic countries have deep historical roots. Copenhagen, the capital of Denmark, was granted autonomy through administrative reforms in 1840. Nine years later local self-government was legally implemented in the first constitution in Denmark. The Finnish local governments are granted the same privileges by law, dating back to the Finnish independence in 1917. The Swedish constitution has long granted local governments and county councils considerable autonomy and independent powers of taxation. The right to levy taxes has, for example, been a part of local government ordinances since 1862.

BOX 2

CONSTITUTIONALLY GUARANTEED  
LOCAL GOVERNMENT IN DENMARK,  
FINLAND AND SWEDEN

THE DANISH CONSTITUTION

SECTION 82

The right of the municipalities to manage their own affairs independently under the supervision of the State shall be laid down by statute.

THE FINNISH CONSTITUTION

SECTION 121: Municipal and other regional self-government

(1) Finland is divided into municipalities, whose administration shall be based on the self-government of their residents.

(2) Provisions on the general principles governing municipal administration and the duties of the municipalities are laid down by an Act.

(3) The municipalities have the right to levy municipal tax. Provisions on the general principles governing tax liability and the grounds for the tax as well as on the legal remedies available to the persons or entities liable to taxation are laid down by an Act.

(4) Provisions on self-government in administrative areas larger than a municipality are laid down by an Act. In their native region, the Sami have linguistic and cultural self-government, as provided by an Act.

THE SWEDISH CONSTITUTION

ARTICLE 2

(2) Swedish democracy is founded on freedom of opinion and on universal and equal suffrage. It shall be realised through a representative and parliamentary polity and through local self-government.

ARTICLE 7

(1) There are primary and regional local government communes in Sweden. The decision-making power in the communes is exercised by elected assemblies.

(2) The communes may levy taxes in order to perform their tasks.



**TASKS: PRACTISING WELFARE EVERY DAY**

Citizens in the Nordic countries encounter their local government in their everyday lives. Most very young children are taken care of at the local municipal nursery or kindergarten while their parents are at work. Most children attend the local municipal school, and if a child has special needs, the local government is obliged to provide help. Older citizens can be granted home care services, such as cleaning, from the local government. If they need to be looked after around the clock, they move into the local nursing home. Libraries, football fields and services for

local businesses are also local government service areas. The local authorities have a big and often hotly debated responsibility to prioritise between all of these services.

The central government in the Nordic countries handles tasks such as policing, defence, implementing laws, as well as deciding overall economic policy. Almost all other public tasks are carried out by local governments.

It is a guiding principle that tasks should be planned and performed as close to the citizens as possible, while not giving up on the advantages of economics of scale. This is called the principle of proximity.

**NORDIC MUNICIPALITIES ARE LARGE**

Number of municipalities and their size in different countries

	DENMARK	SWEDEN	FINLAND	UK	GERMANY	FRANCE	JAPAN
Number of municipalities	98	290	336	406	11.553	36.697	3.100
Average no. of inhabitants	56.590	32.340	15.960	152.680	7.080	1.770	41.308

FIGURE 4 Nordic municipalities are quite large by international comparison. The size has changed with the continuing ambition to find the right balance between economics of scale and the advantages of proximity.

Source — EU Subnational Governments, 2010 key figures, The Council of European Municipalities and Regions (CEMR) and Local Government in Japan, Council of Local Authorities for International Relations (CLAIR)

Local governments in all the three countries provide:

- PRIMARY EDUCATION
- SOCIAL SERVICES
- CARE FOR THE ELDERLY
- KINDERGARTEN, CHILD CARE AND PRESCHOOL
- WASTE HANDLING AND ENVIRONMENTAL PROTECTION
- WATER SUPPLY
- LIBRARIES
- SPORTS FACILITIES

Most of the services listed are mandatory. Local governments are obliged by law to provide them to their citizens. However, the local governments have an important say in how they decide to provide the services. They can hire a private company to take care of the elderly, they can spend more on cultural activities or they can collaborate with neighbouring local governments on shared services. Normally the national legislation will define the minimum requirements for public and social services that every citizen is entitled to, but say little about how the tasks must be handled. Actually most of the social services were first developed and tested in the municipalities before every citizen's right to these services was decreed by national law.

The local governments can provide this wide range of services because they are of a substantial size. The average number of inhabitants in a Danish municipality is 56,590, the Swedish municipalities have 32,478 inhabitants on average, and the average size of Finnish municipalities is 16,006 inhabitants. Compared to other developed countries with a local government structure, Nordic

municipalities are relatively big. German municipalities, for example, only have about 7,000 inhabitants on average and French municipalities are down to an average size of 1,770. When it comes to size, the Nordic municipalities are best compared to the Japanese. See figure 4.

The right size and necessary competencies for solving all of the municipal tasks are continually up for debate. The goal is to find the optimal balance between the advantages of economies of scale, which can be achieved by larger units, and the advantages of local units that foster pragmatism and accountability through proximity. See box 3.

**ACCOUNTABILITY**

Local governments are run by councils which are democratically elected by local voters. Local politicians decide on service and tax levels and are directly accountable to citizens in the municipalities. Local elections are widely debated and participation is high in all three countries. Since 1980, the average participation rates in Denmark and Finland have been 72 and 66 percent. In Sweden local elections are held together with the national election, ensuring a participation rate at 83 percent.

Civil servants employed by the local governments implement the councils' decisions. The Nordic local governments employ a large and varied share of the workforce. In Denmark, Finland and Sweden about a fifth of the total workforce is employed by local or joint authorities, with the vast majority of these working in health care, education and social services. Thus a lot of Danes, Finns and Swedes either work for or are very familiar with people who work for local government services.

Historically the public administrative structures >

BOX 3

### MERGING MUNICIPALITIES FOR SUSTAINABLE UNITS



IN RECENT YEARS A MUNICIPAL MERGING process has gone through the Nordic countries in order to create larger and more sustainable units.

In 2005 the government in Finland started a process to consolidate the municipal self-rule through municipal mergers and increased cooperation. The merger process that has recently gained new momentum has reduced the number of municipalities by almost a hundred.

As an example of the effort to address the challenge of sparsely populated land, the 10 municipalities in the Kainuu Region in eastern Finland started cooperating on administration in 2005. Kainuu became the first self-governing region in Finland with joint authority of all social and health care services as well as upper secondary and vocational education. Some 3,800 persons formerly employed by the different municipalities now work for the Kainuu Region. The Kainuu experiment is an attempt to optimise the decentralised administration of the municipalities.

In 2007, the number of municipalities in Denmark was

reduced from 271 to the current 98. The reform aimed to create economies of scale in the bigger municipalities, which was expected to lower costs. Furthermore, the bigger units would be able to provide more services and afford more specialised staff. The reform was thereby also expected to increase professional competence in the local governments.

After some initial trouble most Danish municipalities are now showing the expected results when it comes to more efficient governance. Though the debate is ongoing as to what the consequences have been to the local democracy, it seems certain that the number of Danish municipalities will remain the same in the years to come. The only likely changes could be mergers between some of the smallest municipalities, whose size and sustainability is widely debated.

It is crucial to understand, however, that the debate centres on the question of how the municipalities are to be kept most effective, and not whether or not they should exist or remain the centre of welfare production.

– both nationally and locally – in the three countries are transparent and meritocratic. The decentralised administrations thus adhere to the highest standards of public administration. In 2011 Transparency International rated Denmark, Finland and Sweden among the four least corrupt countries in the world. See figure 5.

One could fear that this dispersion of responsibilities could lead to less effective governing than a centralised organisation. However, this is not the case.

According to international rankings, as well as the general opinion of the citizens, government efficiency in the three countries is high. The World Bank ranks the world's countries in accordance with government effectiveness and in 2010 the three countries took three of the first four places. See box 4 and figure 7.



### AMONG THE LEAST CORRUPT COUNTRIES IN THE WORLD

Ranking of the least corrupt countries in the world

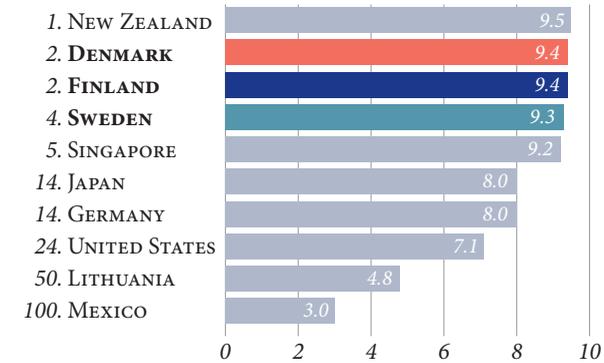


FIGURE 5 1-10 with 10 being maximum

Source — Corruptions Perceptions Index 2011, Transparency International.

### EFFECTIVE GOVERNMENTS

Score of government effectiveness with 100 being best

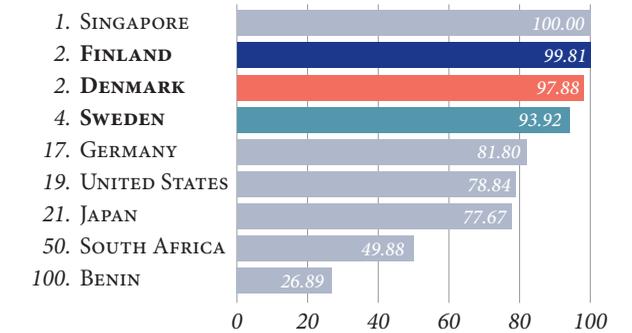


FIGURE 7 Public bureaucracy in the Nordic countries is efficient and fast.

Source — Government effectiveness, World Governance Indicators 2010, World Bank, 2010

BOX 4

### TRUST MAKES SOCIETY RUN SMOOTHER

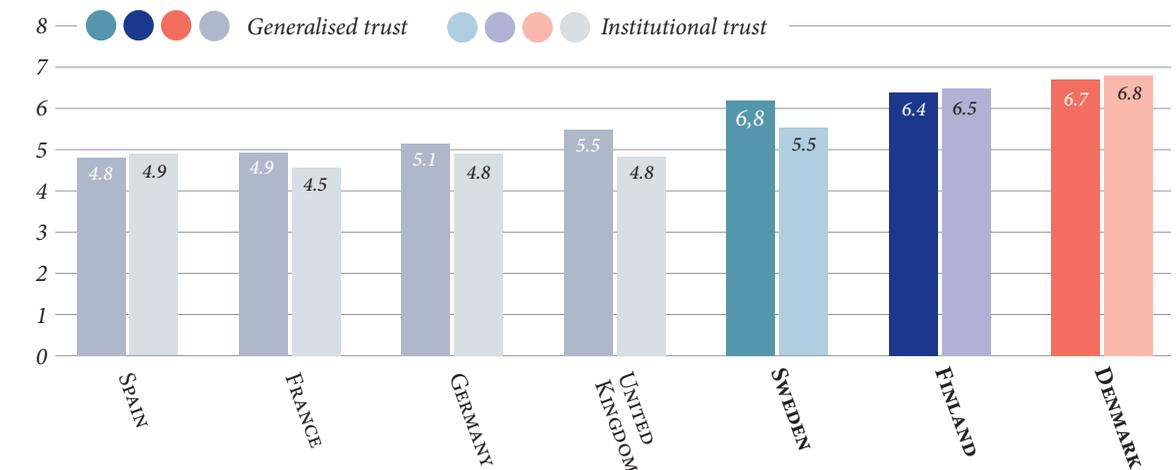
DENMARK, FINLAND AND SWEDEN are among the countries in the world where the levels of both general trust and institutional trust are highest. Researchers debate whether the high levels of trust have led to the Nordic Model or if it is the other way around. Either way it is evident that the two coincide.

The high level of trust pays off in many ways. Trust is the

basis of low rates of crime and corruption and well-functioning institutions. Furthermore, trust serves as a lubricant that helps to make transactions, communication and learning function smoothly and efficiently. In short it provides for better solutions for the citizens and the municipal administrations.

### HIGHEST LEVELS OF TRUST IN THE WORLD

Generalised and institutional trust



Source — Antti Kouvo (2011): "The sources of generalized trust and institutional confidence in Europe", in Research on Finnish Society, Vol. 4 (2011).

*The Nordic Model is a result of a continuous and incremental development of public services. Together these building blocks form the present system.*

**TIME LINE**

**-1920**

**1920-50**

**1950-80**

**1980-today**



**POVERTY LAWS AND PHILANTHROPY**

Acts against child labour and other initiatives against poverty were the first examples of state intervention in the free (labour) markets. Most acts were financed through taxes or insurances and central government financing. Importantly, women also gained suffrage in this period.

**SOCIAL RIGHTS**

The Social Democratic party formed government in Denmark and Sweden. Workers and farmers in all three countries organised unions and cooperative movements, and together implemented several reforms extending social rights from smaller to broader groups in the societies.

**THE GOLDEN AGE OF WELFARE**

All policy dimensions were knitted together into a framework of the welfare model, including social security, pensions, care for the elderly, children, the disabled, health services, education, research, and cultural policies. Universalism became a standard feature. The development meant a massive expansion of the public sector, especially at the level of local government. The majority of the many new employees in the welfare sector were women.

**FOCUS ON COMPETITIVENESS**

In the 1980s and 1990s, all three countries went through severe economic crises. Fixed currencies, tight fiscal policies and export-led growth put the three countries back on track. Now – with past troubles in mind – competitiveness and economic reforms to further growth are hot topics in the Nordic countries, where welfare systems are being reformed with a focus on maximal utilisation of the work force.



Source – Christiansen et al. (2006): The Nordic Model of Welfare – a historic reappraisal. Museum Tusulanum Press.

ARTICLE 2

# THE NORDIC BALANCE

– High taxes, high social service levels

Why are taxes high in the Nordic countries? And how is the Nordic Model still highly competitive and less expensive than other welfare models?



Denmark and Sweden top the OECD chart for total tax revenue as a percentage of GDP and Finland is close behind as number 7 among the 31 OECD countries. With total tax revenues at 48.2, 42.1 and 45.8 percent of GDP respectively in Denmark, Finland and Sweden, all three countries are well above the OECD average of 33.8 percent. See figure 1.

Historically, the total tax revenue as a percentage of GDP rose in the three countries from the end of World War II to end of the 1980s or the beginning of the 1990s during the expansion of the welfare state. See figure 2.

Looking at the numbers, one could expect that Danes, Finns and Swedes would be unhappy with these tax levels, and that the Nordic Model must be one of the most expensive ways of delivering social services. However, neither of these conclusions would be correct. The citizens accept the high taxes because they feel they get something for their money. Furthermore, research shows that the

Nordic Model is less expensive than the welfare systems in France, Germany or the United States.

### CITIZENS WANT TO PAY

Research has continuously shown that citizens in Denmark, Finland and Sweden are among the Europeans most likely to agree when asked whether “the government should increase taxes and social spending”, despite already having some of the highest tax rates in the world. See figure 3.

The population is largely satisfied with the current level of services and this accounts for the high level of support, according to experts.

“In contrast to, for example, the Americans, Danes feel that they get something of value in return for their taxes – for example, well-functioning schools and hospitals. Therefore, tax is seen as a price worth paying,” Christoffer Green-Pedersen, professor of political science at Aarhus University and an expert in the Nordic public sector, explains.

### HIGH TAX LEVELS

Total tax revenue as percentage of GDP.

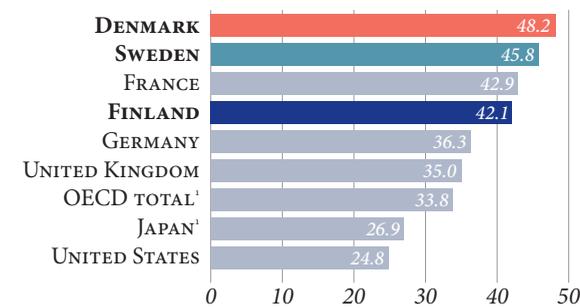


FIGURE 1 Denmark and Sweden have the highest share of tax revenues compared to GDP. Finland does not trail by much.

Note: 2009 figures.  
Source – OECD, 2010.

### WILLING TO PAY

The government should increase taxes and spend more on social benefits and services, mean on a scale from 1-7, 2008. 7 means “strongly agree”, and 1 means “do not agree at all”.

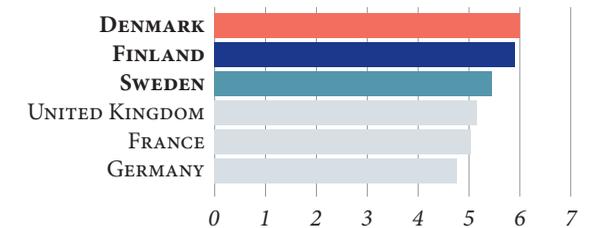


FIGURE 3 Asked whether or not they would be willing to pay higher taxes in exchange for more social services, Danes, Finns and Swedes are among the people in the world who agree the most.

Source – The Danish national centre for social research.

### TAX LEVEL DEVELOPMENT

How the total tax revenue as percent of GDP has developed from 1965-2010

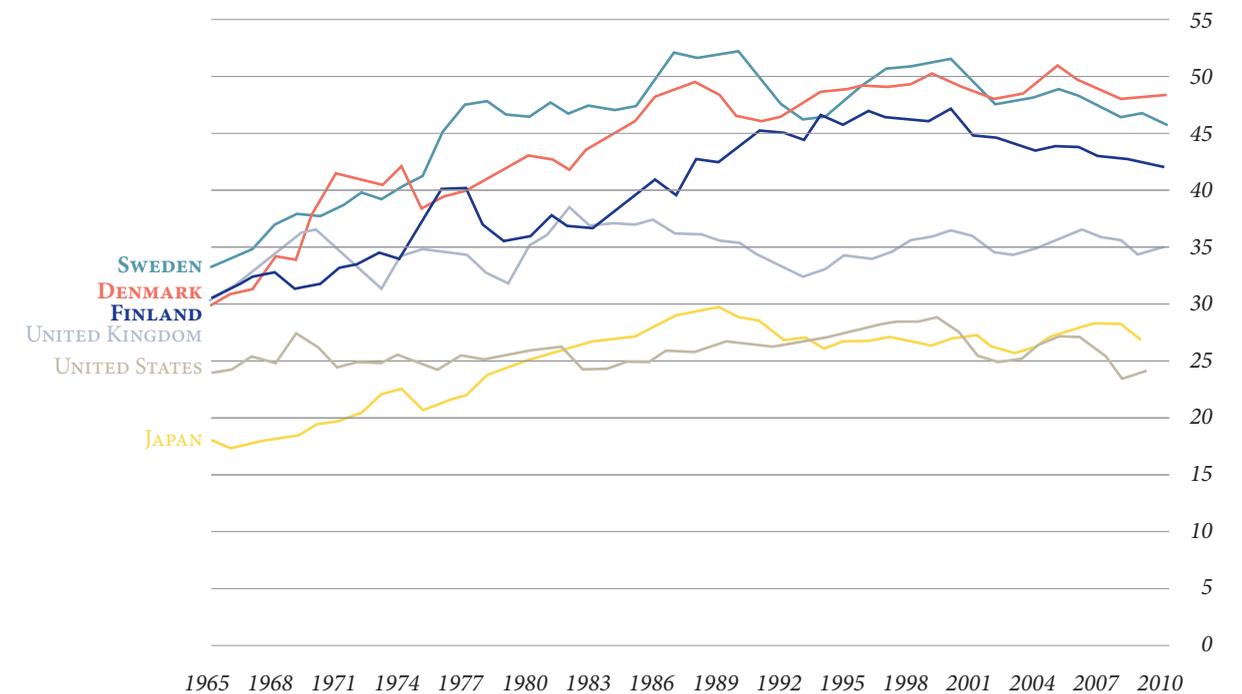
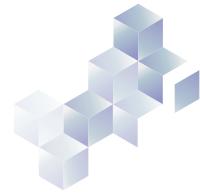


FIGURE 2 Tax levels have been rising more in Denmark, Finland and Sweden over the last 50 years than in other countries.

Source – OECD.



This relation between high taxes and high quality is pivotal to the stability of the Nordic Model. The high public support behind increasing taxes and social spending go hand in hand: Whereas citizens in most other countries have to get insurance or pay out of pocket for social services and benefits, these are to a very large extent tax-financed in Denmark, Finland and Sweden. It is simply a matter of financing the social goods in another way.

#### TAXES PAY FOR A WIDE RANGE OF SOCIAL SERVICES

The welfare services in the Nordic countries are partly tax-financed and partly financed by user payments, but this share of user payments is far less significant than in other countries. In Denmark, Finland and Sweden taxes pay for some or all of the costs associated with:

- PRIMARY EDUCATION
- SECONDARY AND TERTIARY EDUCATION
- SOCIAL SERVICES
- HEALTH SERVICES
- CARE FOR THE ELDERLY
- CHILD CARE AND PRESCHOOL
- WASTE HANDLING, ENVIRONMENTAL PROTECTION AND WATER SUPPLY
- LIBRARIES, SPORTS FACILITIES AND A VARIETY OF CULTURAL OFFERINGS

For the average Dane, Finn or Swede this means that they do not have to pay for their children to go to primary school or high school and they do not save for years to put their children through university. They do not need insurance to go to the hospital, get medication or see a doctor, and if they lose their job, relatively generous unemployment benefits are supplied by a combination of insurance and public funds. The elderly in Denmark, Finland and Sweden do not need insurance and do not have to pay out of pocket to get necessary help with cleaning or personal assistance and most of the costs associated with day care for children are also tax-financed.

All of these services are universal rights that citizens in the three countries can claim regardless of their

occupational situation, where they live, whether or not they have insurance, or their financial situation. Some of the services require the recipients to pay a minor fee or to contribute financially in some way, but the major part of the expenses is tax-financed. This “free and equal access” to social services, as it is coined, is considered a cornerstone of the Nordic Model and enjoys wide public support. A lively debate ensues whenever the universal principle is questioned by political parties and opinion makers.

#### HIGH PERCEIVED QUALITY AND EFFICIENCY

The tax discussion in the Nordic countries focuses on the quality and efficiency of the public sector. When you pay a lot, you demand a lot, is the principle that seems to be guiding the debate.

Citizens in Denmark, Finland and Sweden are generally very satisfied with the social services they receive. Surveys among parents with children in day care or primary school, patients in hospitals, elderly citizens receiving care and other recipients of public services in the three countries reveal high levels of satisfaction. 70 percent of the elderly in Sweden are satisfied with the quality of care that they receive and only 7 percent are very unsatisfied. 96 percent of Danish patients are satisfied with the medical care and 93 percent are satisfied with the quality of hospitalisation. 77 percent of Finnish parents with children in primary schools have great confidence in their local school.

A distinct source of public support for the relatively high tax levels and social spending is the overall efficiency of the governments in the three countries. Denmark, Finland and Sweden have some of the best governance in Europe; according to a large study by the University of Gothenburg for the European Commission, Denmark, Sweden and Finland are ranked 1, 2 and 3 in the EU. See figure 4.

#### HIGH TAX LEVELS DO NOT PREVENT COMPETITIVENESS

High taxes and high public expenditures are not at odds with economic growth and job creation. In fact, investing in education and social services seems to raise competitiveness in the Nordic countries. Many welfare services are perceived more as an investment in a

### QUALITY OF GOVERNMENT RANKINGS IN THE EU

Quality of government study result

1. Denmark
2. Sweden
3. Finland
4. Netherlands
5. Luxembourg
6. Austria
7. Germany
8. United Kingdom
9. Ireland
10. France
11. Belgium
12. Malta
13. Spain
14. Portugal
15. Cyprus
16. Estonia
17. Slovenia
18. Czech Republic
19. Lithuania
20. Hungary
21. Slovakia
22. Greece
23. Latvia
24. Poland
25. Italy
26. Bulgaria
27. Romania

FIGURE 4 According to a recent study, Denmark, Finland and Sweden have the highest quality of governing in the EU.

Source — The quality of government at the national as well as regional and local level is measured by indicators such as the level of corruption; rule of law, e.g. behaviour of the police force; bureaucratic effectiveness, e.g. public education and public healthcare; and government voice and accountability, e.g. fair elections and role of media. University of Gothenburg (2010): Measuring the quality of government and subnational variation. Report for the European Commission Directorate-General Regional Policy Directorate Policy Development.

#### BOX 1

### A WORLD CLASS TAX SYSTEM

THE WORLD'S MOST EFFICIENT tax collection systems ensure a steady flow of funds for public services and keep tax evasion very low.

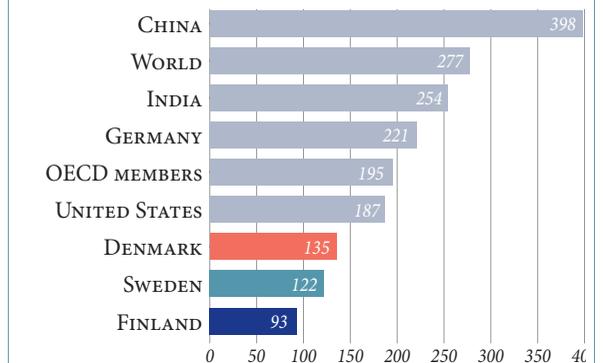
Tax is collected at the source, meaning that the employer withholds the tax and pays on behalf of their employee every month. This is in line with the guiding tax principle of third party reporting which ensures that employers, banks, insurance companies, pension funds, etc., are obligated to provide the tax administrations with relevant data. The reporting works automatically and is digitalised, which makes it very reliable and helps to minimise the tax gap. In short, it is almost impossible to cheat.

The extremely low corruption rates and the high quality of government institutions also helps to make the Nordic tax collection systems some of the most efficient in the world. That is also the reason that tax collectors from Denmark and Sweden were called upon by the EU to help design and implement an effective tax collection system in Greece following the large economic stimulus packages in 2012.

SOURCE: Tax agencies in Denmark, Finland and Sweden

#### EASY TO PAY TAXES

Time spent on reporting taxes (hours)



Time to prepare and pay taxes is the time, in hours per year, it takes to prepare, file, and pay (or withhold) three major types of taxes: the corporate income tax, the value added or sales tax, and labour taxes, including payroll taxes and social security contributions.

Source: World Bank, Doing Business project

## FLEXIBLE WORKFORCE

Labour turnover rate (hiring and firing), percentage of employment, 2010

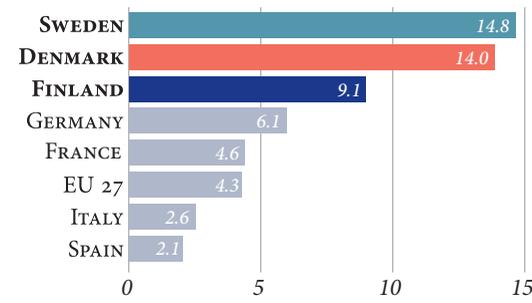


FIGURE 5 A larger proportion of Danes, Finns and Swedes change jobs than their fellow Europeans. This flexibility is encouraged through generous benefits and allows companies as well as workers to act in a more flexible way in the market.

Source – Eurostat.

## LIFELONG LEARNING

Percentage of the population aged 25 to 64 participating in education and training

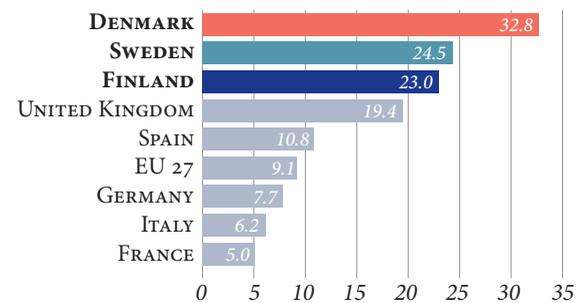


FIGURE 6 A much larger share of adult Danes, Finns and Swedes are engaged in education and training than in comparable countries.

Source – Eurostat.

## THE NORDIC MODEL IS INEXPENSIVE

Gross and net social spending in selected countries, percentage of GDP, 2007

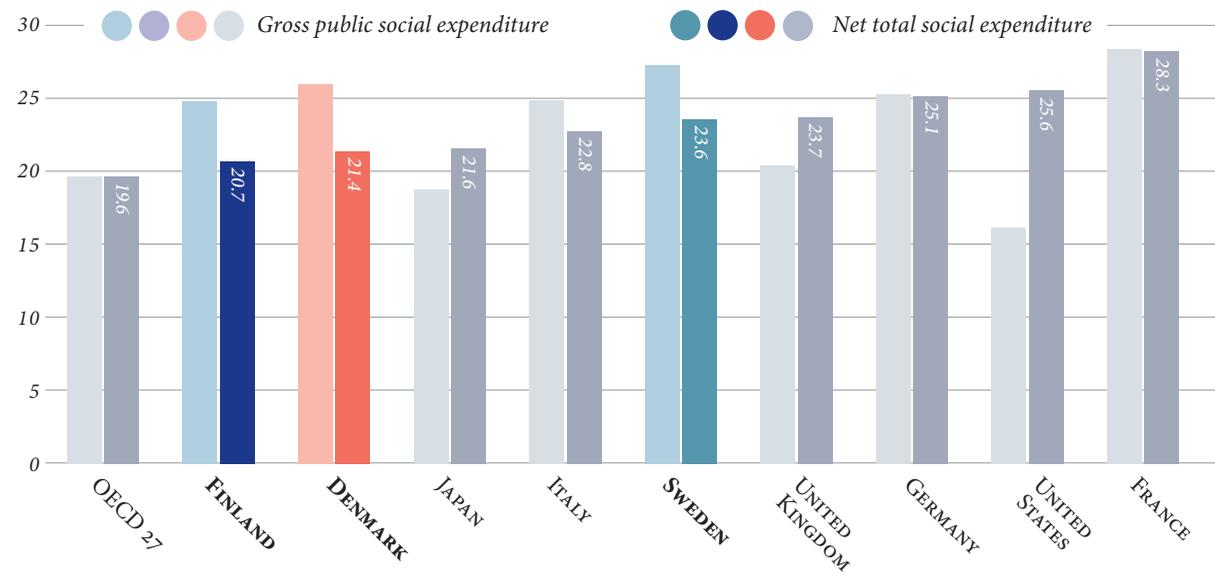


FIGURE 7 The welfare system in the three Nordic countries is not expensive by international comparison. Net total social expenditure designates the share of GDP spent on social services through private and public payments.

Source – OECD (2011): “Is the European welfare state really more expensive?”.

productive workforce than as a cost to society.

Researchers argue that the strong economy and high international ratings of Denmark and the other Nordic countries can be attributed to their institutional competitiveness.

Firms derive competitive advantages from operating within a society with an efficient set of political and economic institutions. In this light, universal social services such as day care, education, maternity leave and health care can be seen as elements benefiting companies in Sweden, Denmark and Finland. The case of unemployment benefits exemplifies this connection.

If you lose your job in Sweden, you can expect to receive an earning-related daily allowance of up to 80 percent of your normal income, with a limit of approximately 100 USD per day for the first 200 days of inactivity, which drops to 70 percent for the following 100 days. The same goes – with some differences – for unemployed in Denmark and Finland.

The relatively high unemployment benefits are only one of several components that can be seen as an example of the “Nordic compromise” on the labour market. Instead of having businesses competing over wages and labour unions demanding more detailed employment legislation, the Nordic countries have chosen a different strategy.

High unemployment benefits and education for unemployed are combined with an active labour market policy that engages the unemployed to continuously apply for jobs. This means that it is relatively easy to fire workers because they are provided for when they are unemployed. This makes employers more inclined to hire. Therefore Denmark and Sweden, in particular, have some of the highest labour turnover rates in the world. See figure 5.

As a result, companies are able to be more flexible when agreeing to new orders. Because it is cheap to hire and fire, the companies are more prone to adjusting their businesses according to the state of the market, which in turn ensures better labour market utilisation.

Flexicurity – an amalgamation of the words flexibility and security – is the term used to describe the strategy of simultaneously enhancing flexibility and security in the labour market. It does so by moving the focus from job security (e.g. difficult to dismiss) towards employment security. Flexicurity thus also focuses on how to continuously ensure the employability of the workforce. See figure 6.

### NOT AS EXPENSIVE AS YOU WOULD THINK

The high quality of government in the Nordic countries leads to a high level of accountability and high quality in social services. One could think that these universal high

quality social services would be very expensive compared to the systems in other countries, but this is not the case.

The welfare systems in the three Nordic countries are not expensive by international comparison. The proportions of GDP used on social expenditure in countries like Germany, Denmark, Finland, Italy, Japan, the United Kingdom and the United States are actually within only a few percentage points of each other, as shown by the OECD rankings. See figure 7.

This makes the Finnish model 7.6 percentage points cheaper than the French model and 4.9 percentage points cheaper than the American model. Even Sweden, the biggest gross social spender, has a cheaper system than the United States, with its net social expenditure two percentage points lower than the American system.

The OECD compares the share of GDP spent on social services though both private and public payments (designated net total social expenditure). Here they find that the Nordic countries spend less than many other developed countries. Finland spends 20.7 percent of its GDP on social expenditure with Denmark and Sweden spending only a little more. In comparison the United States spends 25.6 percent of its GDP on social expenditure and France tops the list of the 31 OECD countries with 28.3 percent.<sup>1</sup>

The private and social insurances and out of pocket expenses that citizens in most other countries must pay for services raises the net social expenditure and causes higher administrative costs. This shows that paying for social expenditure through taxes – as is the principle of the Nordic Model – is a cheap way to organise social welfare.

It is therefore understandable that the Danes, Finns and Swedes are satisfied with their tax-based social welfare. It delivers services of high quality, enhances economic competitiveness and is actually pretty cheap compared to systems in other countries.

<sup>1</sup> The reason that net total social expenditure (the share of GDP spent on social services through private and public payments) is less than gross public social expenditure (the share of GDP spent by the public sector on social services) is quite simply, that the Nordic countries tax social benefits as income. Therefore a portion of the social spending returns to the government as revenue.

The Nordic countries are small open economies. With a long history of trading globalisation is not a new phenomenon to Nordic businesses. They have been reliant on constant adaptation to the developments in the outside world for decades, and today almost half of the Nordic GDP comes from export.

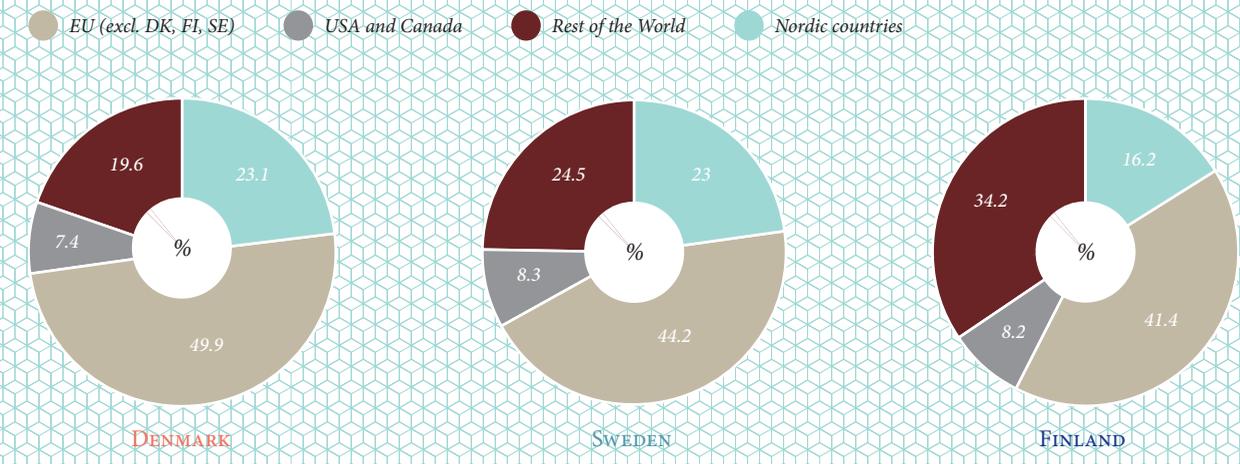
**LONG HISTORY OF OPEN EXPORT ECONOMY**

Export as percentage of GDP 1960-2010



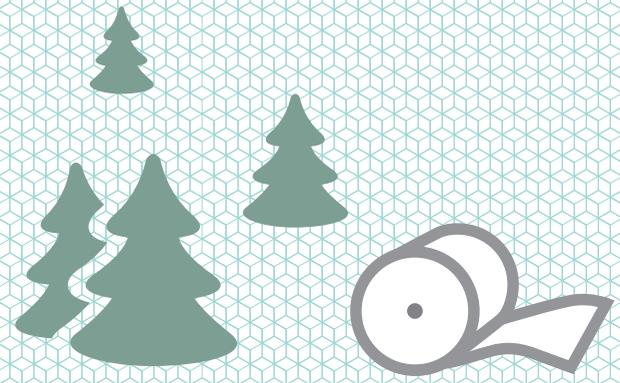
Source – World Bank

**WHERE THE EXPORTS GO**



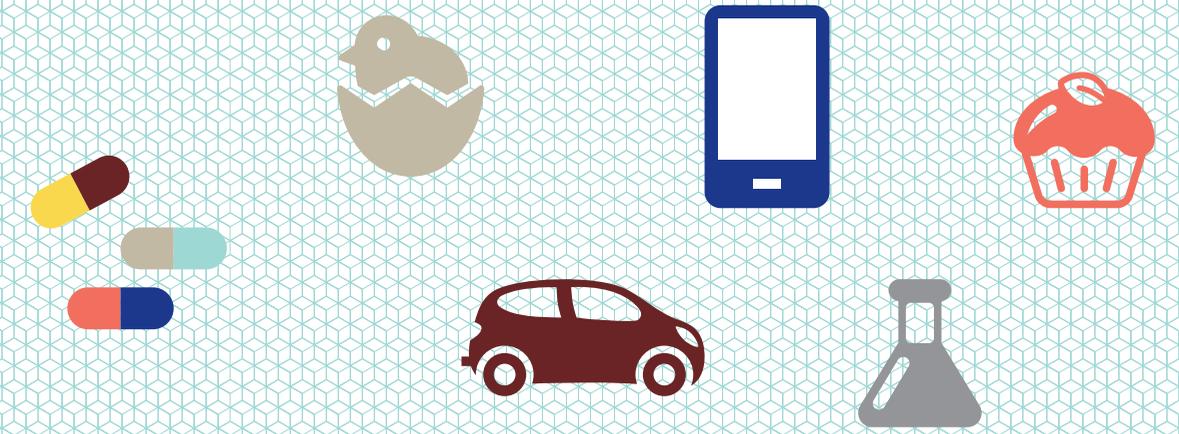
**MOST EXPORTS TO WESTERN MARKETS**

The EU-countries, Germany in particular, are the biggest buyers of Nordic commodities. Their import constitutes between 34.0 and 44.2 percent of Nordic export, with Nordic businesses benefiting from the internal European market. Intra-Nordic trade is also a major part of the countries' export and makes up between 16.2 and 23.1 percent. USA and Canada are also major trading partners constituting between 7.4 and 8.3 percent of the Nordic export.



**EXPORTED PRODUCTS**

Finnish exports are primarily wood, paper and paper products and telecommunication equipment. Danish and Swedish exports are more equally distributed between different products, with processed food, pharmaceuticals and chemical products as the major Danish export products, and cars, wood, paper products and telecommunication equipment as predominant Swedish exports.



ARTICLE 3

# DEVELOPING THE NORDIC MODEL

## – Cooperation and compromise

How the Nordic Model has evolved over time in a political culture of collaboration and stability.



Decision makers and the people of Denmark, Finland and Sweden agree on one thing: The Nordic Model should stand. This is not an issue in the public debate.

“It is considered almost illegitimate to launch a frontal attack on the welfare state, and it is definitely not advisable for any party which wants to keep and increase its electoral support to do so,” a group of respected historians conclude in *“The Nordic model of welfare - a historical reappraisal”*.

Heated debate is generated, however, when it comes to how the Nordic Model should be managed, organised and developed. Develop to maintain has been a catch phrase among politicians, economists, labour market organisations and engaged citizens.

To understand this debate properly, one needs to acknowledge that the Nordic Model has been developed through perpetual reforms. It does not build on a blueprint or grand design, but has evolved gradually. And because parties from both sides of the political spectrum have contributed to the development of the model for more than a century, it is founded on a general consensus.

All parts of society have played a part in this process. Labour unions, employers and cooperative movements have been heard, as well as represented, by their respective

parties in multiple cross-bloc political compromises. See *box 1*. A broad alliance has stood behind almost all major welfare reforms in the three countries, making the reforms quite resistant to changes in the parliamentary balances. This is a fundamental aspect of the political culture in the three countries.

### POLITICAL SYSTEM PROMOTES COOPERATION AND STABILITY

The parliamentary systems in the Nordic countries promote the representation of multiple parties. See *box 2*.

The central governments in all three countries are most often based on a coalition, and in Denmark and Sweden they are very often minority governments in need of support from opposition parties. This system favours broad negotiations and consensus-seeking both among coalition partners in the cabinet and between the government and the opposition. Historically this has helped to ensure stability and continuity within the political system.

Figure 1 shows that 87 percent of Danish governments between 1945 and 2003 were minority governments. In Sweden the share is 69 percent. In comparison the United Kingdom and Germany have only had one minority government in the same period. Finland has instead had

### SWEDEN AND DENMARK TOP THE CHART WHEN IT COMES TO MINORITY GOVERNMENTS

Types of government in Western Europe 1945-2003, percent

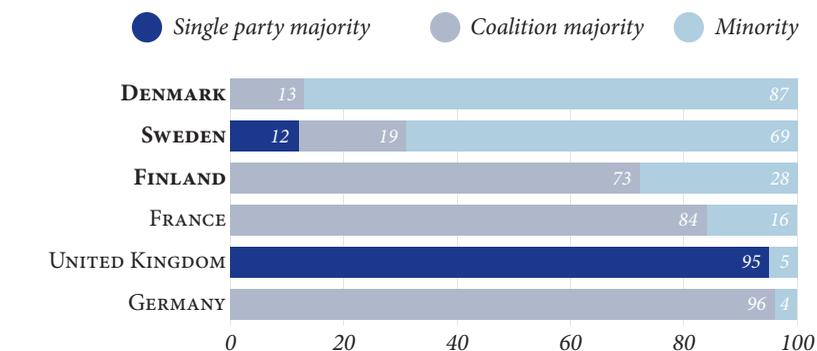


FIGURE 1 Denmark and Sweden have a long history of minority governments. Less so in Finland, where coalition governments are the norm.

Source — Gallagher, Michael & Michael Laver, Peter Mair (2006) Representative Government in Modern Europe

BOX 1

### WORKERS AND FARMERS AND WELFARE COALITION



**THE DANISH KANSLERGADE SETTLEMENT** and the Swedish Kohandel reform are examples of cross-bloc alliances that helped shape the Nordic Model. In both cases the Social Democratic government came to an agreement with the agrarian party to address the economic crisis in the 1930s, at the same time laying the grounds for the modern Nordic welfare state and establishing a consensus-seeking tradition.

**KOHANDELN, 1932:** The Swedish Kohandel reform was a compromise between the interests of farmers and workers made between the Social Democratic government and the agrarian party Bondeförbundet. The settlement was modest in scope, but the worker-peasant alliance was seminal in the sense that it marked the beginning of 44 years of uninterrupted Social Democratic government in Sweden with the Bondeförbundet (the later Centerpartiet)

as a frequent collaborator, either as direct government participation or as parliamentary support.

**KANSLERGADEFORLIGET, 1933:** The bipartisan reform agreed on in Kanslergädeförliget was designed to address the economic crisis of the depression, but it also involved a far-reaching social reform, simplifying the existing 54 social laws into just four. The reform made benefits available to the majority of the population and established clear-cut citizens' rights. The charity-oriented approach to social reforms was abandoned leading the way for the development of the modern Nordic welfare state. The reform was made in the then Social Democratic Danish prime minister Thorvald Stauning's private home in Kanslergade (hence the name of the reform) in Copenhagen, and was negotiated in a cross-bloc agreement between the Social Democratic government and the agrarian party Venstre.

*“This pragmatic consensus-culture in both political and corporate life is even more pronounced in the local governments where the political life is extremely pragmatic and non-partisan.”*



## OPPOSITION PARTIES INFLUENCE GOVERNMENT POLICY

Estimated impact of opposition parties on government policy, scores 1 (low) to 9 (high)

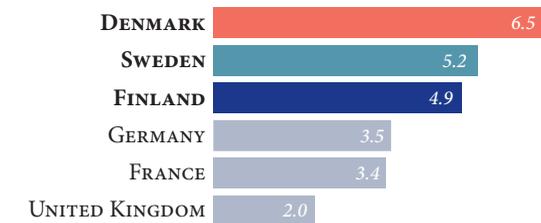


FIGURE 2 The political culture and institutions give the opposition a higher impact on government policies than in many other countries.

Source — Gallagher, Michael & Michael Laver, Peter Mair (2006) Representative Government in Modern Europe.

### BOX 2

## MANY PARTIES IN PARLIAMENT

RELATIVELY LOW ELECTION THRESHOLDS and a proportional representation electoral system allow for a broad representation of parties in the parliaments and create the basis for a multi-party system in the Nordic countries. Finland has no election threshold, in Sweden it is four percent, and in Denmark the election threshold is only two percent.

In 2012, seven parties are represented in the Swedish parliament, Riksdagen, eight parties in the Danish parliament, Folketinget, and eight parties in the Finnish parliament, Eduskunta. These numbers are relatively high by international comparison.

SOURCE: Folketinget.dk, Riksdagen.se, Eduskunta.fi

### BOX 3

## THE FINNISH RAINBOW GOVERNMENTS

NO ONE PARTY has ever held an absolute majority in the Finnish parliament. On the contrary, Finland has a solid tradition for cross-block coalitions.

In eight years and through multiple elections, from 1995 to 2003, the Social Democratic Chair Paavo Lipponen led a so-called rainbow coalition consisting of his party, the Left-Wing Alliance, the Swedish People’s Party and the National Coalition Party.

SOURCE: Folketinget.dk, Riksdagen.se, Eduskunta.fi

a long tradition for broad, cross-block coalition, majority governments. See box 3.

Another feature that sets the Nordic countries apart is that Denmark, Finland and Sweden, together with Italy and Norway, are among the countries in Europe where the opposition has the greatest influence on policy making. See

figure 2.

With cross-political ownership of the political agreements, a shift in governmental power does not mean a total shift in policies. This has resulted in a relatively stable political environment with many political agreements carried over from one government to another.

The tradition for broad negotiations and cross-block alliances is even more pronounced in the local governments. The local governments are run by elected councils, where parties normally have to cooperate to form a majority behind the mayor. Such coalitions are also often broad in an ideological sense, as they in some cases encompass right- and left-wing parties at the same time.

### THE CONSENSUS CULTURE PREVAILS LOCALLY

There are obviously also contrasting interests among different groups in the Nordic countries and debates and controversies as to how big the public sector should be and what role it should play. But conflict levels are low and both businesses and unions are often asked for their input or are directly involved in large reforms no matter which parties are in government.

This pragmatic consensus-culture in both political and corporate life is even more pronounced in the local governments where the political life is extremely pragmatic and non-partisan. This is underlined by the fact that a number of local coalitions in the Nordic countries accommodate both right- and left-wing parties and that there is a tradition that the sub-committee chairman posts are split among most of the parties represented in the local government councils.

In Finland, for example, the composition of the executive board in the local government is derived from the composition of the council, not along government-

### BOX 4

## LOCAL COALITIONS CREATE STABLE SOLUTIONS

IN THE LOCAL GOVERNMENTS, committees are responsible for making decisions and the mayor is responsible for the daily administration. Seats in the committees are distributed according to election results, and this means that the political minority has an influence on local decision-making.

The committee members are also members of sub-committees which are responsible for certain policy areas. Therefore committee members share the responsibility for administering policy areas of the local government alongside members of different political parties. This promotes a sense of teamwork and reduces the importance of ideological differences.

SOURCE: Kurt Houllberg and Lene Holm Pedersen (to be published): Political Consensus and Fiscal Outcomes, AKF, Danish Institute of Governmental Research (www.akf.dk)

## AN ACTIVE LABOUR MARKET POLICY

Public expenditure on active labour market policies, percentage of GDP, 2010

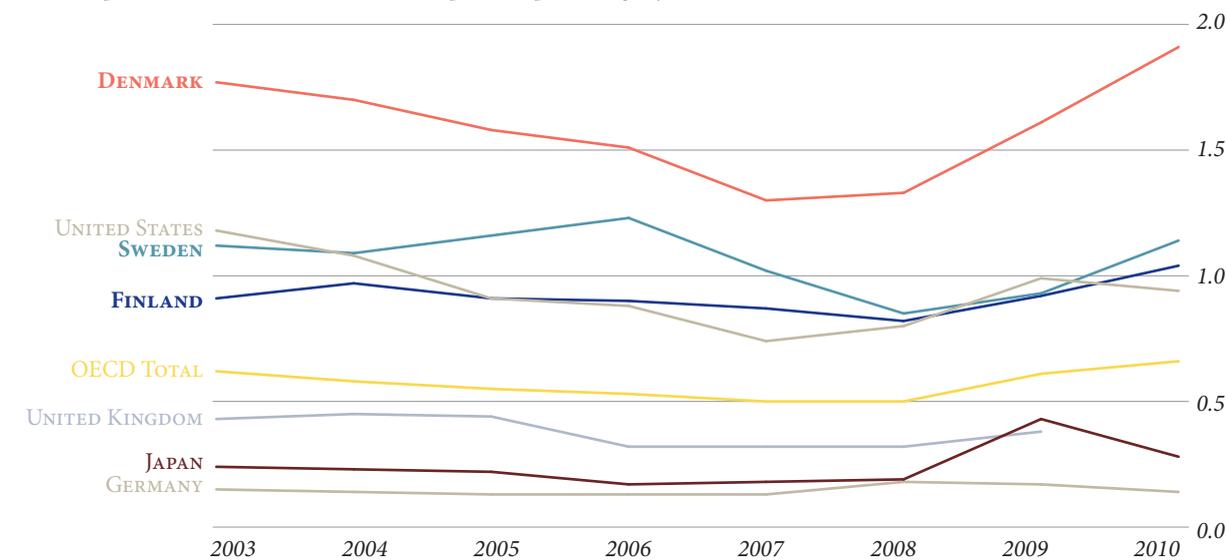


FIGURE 3 Denmark, Finland and Sweden actively use labour market policy

Source — Labour market programmes: expenditure and participants, OECD Employment and Labour Market Statistics (database).

opposition lines as is the case in most national cabinets around the world.

### EVOLUTION BASED ON BROAD ALLIANCES

Nordic welfare policies have been continually developed. Organisations, individuals, political parties and civil society actors have played roles in the perpetual reforms of the Nordic Model. The ongoing development has been based on:

- **LABOUR MARKET INNOVATION:** The Nordic Model has engaged labour market organisations in the formation of labour market policies. They have helped develop work-based education schemes, a high level of shared responsibility, low levels of conflict and a labour market that is both flexible and secure, known as ‘flexicurity’.
- **SOCIAL INNOVATION:** Due to high levels of economic redistribution, the Nordic societies are among the most equal and socially mobile in the world. Day care and care for the elderly have helped secured women’s active participation in the labour market. Reforms of pension age and of social services pushing for active participation by the elderly are underway in all of the Nordic countries.

- **BUSINESS INNOVATION:** Creating an innovative environment free of unnecessary bureaucracy and excess legislation for businesses has been high on the agenda of the central and local Nordic governments – most often across political dividing lines.

### LABOUR MARKET INNOVATION: STRIVING FOR FULL EMPLOYMENT

Employment policies lie at the heart of the labour market policy in the Nordic countries. Active labour market programmes have been important instruments. In Sweden this system was already established in the 1960s. The active labour market programmes serve a double purpose: They upgrade the skills of the unemployed so as to avoid bottlenecks in the labour market, and they encourage the unemployed to remain active and search for jobs. Ultimately, the aim of the system is to avoid long term unemployment with the risk of potential employees dropping out of the labour market altogether, as this would both require public subsidies for this group as well as leading to lost tax revenue.

The labour market organisations play an important role in programmes for further education and training. The organisation rate has historically been very high in the Nordic countries and remains high, although there has been a decrease in the last decades. In Denmark, Finland

## NORDIC WOMEN ARE EMPLOYED

Employment rate of women, percent of female population (15-64), 2011

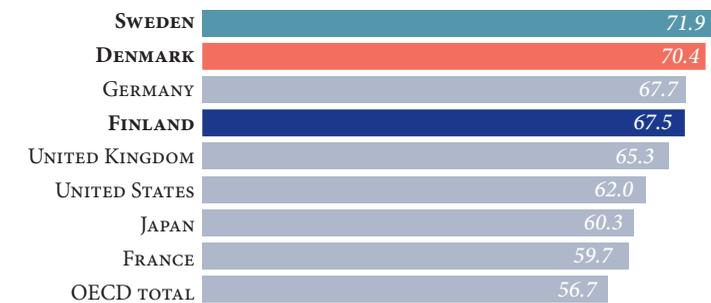


FIGURE 4 Employment rates for Nordic women are among the highest in the world

Source — OECD.

and Sweden the unionisation share remains close to 75 percent of the workforce. No other region in the world reaches comparable figures.

This is important as the Nordic labour market systems rely heavily on collective bargaining. Employers and employees negotiate a collective agreement for a specific industry or area and the state interferes as little as possible when it comes to wage and working conditions. For example, there is no minimum wage in the three countries, as wages are regulated in the labour market agreements.

It is also common for the labour market organisations to negotiate and make agreements more broadly on pensions, unemployment benefits and other social policies.

### SOCIAL INNOVATION: EQUAL OPPORTUNITIES FOR EVERY ONE

The Nordic Model has lessened the impact of social background and gender as factors determining the opportunities of the individual.

High levels of economic redistribution have made Denmark, Finland and Sweden the most equal societies in the world and provide the base for high levels of social mobility. See box 5.

Day care and care for the elderly with a high level of professionalism have enabled more women to participate

actively in the labour market while securing equal opportunities for care for citizens. In 2000, when the EU set up a target to reach a women’s employment rate of 60 percent within ten years, Denmark, Finland and Sweden had already achieved this goal. The Nordic employment rates for women are still among the highest in the world. See figure 4.

Unlike in a number of other developed countries, Nordic families are still having children, even with both parents working, keeping the reproduction rate in the Nordic countries among the highest in Europe. The Nordic average of 1.9 babies per woman is higher than the euro area average of 1.6 children per woman. This has been ascribed to the generous maternity care schemes (and more recently paternity care schemes), high quality day care and after school care.

### BUSINESS INNOVATION WANTED

Creating an innovative business environment without excess bureaucracy and legislation has been high on the agenda of the central and local Nordic governments – most often across political dividing lines. Increasing businesses’ cooperation with scientific communities, building research parks as well as putting counselling and funds at businesses’ disposal, has also been a political priorities >

BOX 5

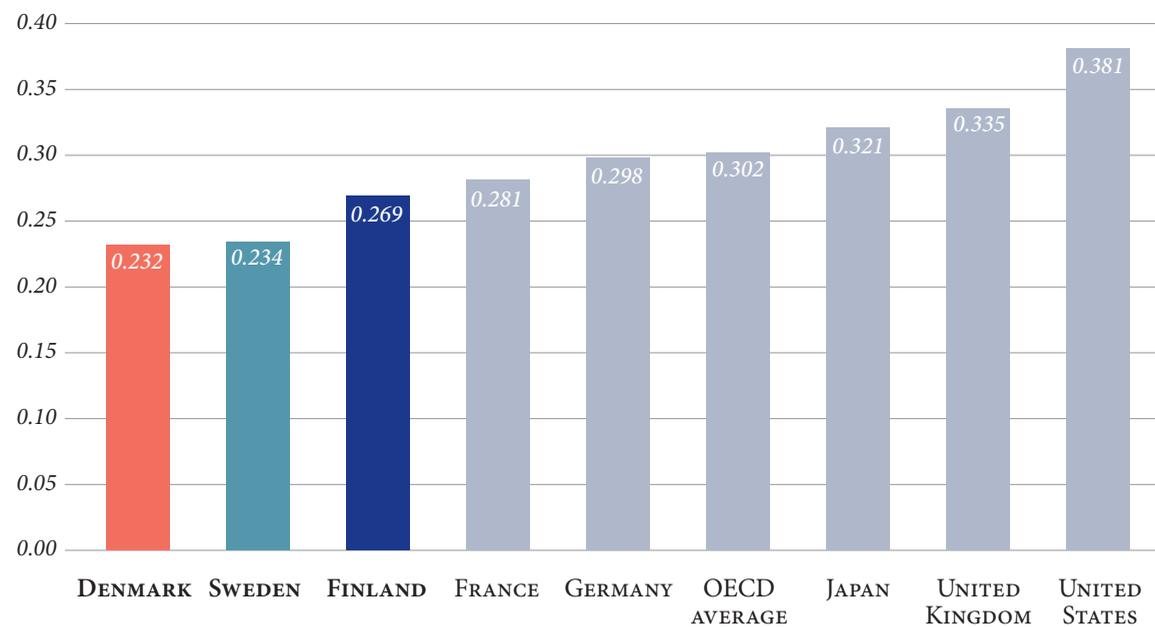
## EQUALITY AND SOCIAL MOBILITY

EVEN THOUGH INCOME INEQUALITY has been rising in recent years, the Nordic countries are still the countries in the OECD with the highest degree of equality, measured by the GINI coefficient. Denmark and Sweden take the two top positions, and Finland doesn't trail too far behind. Income equality provides the basis for social mobility. Research

shows that your social background is less likely to determine your path in life in the Nordic countries than in the United States or the United Kingdom. Some researchers therefore argue that "the American dream" is more easily lived out in the Nordic countries than in the United States.

### EQUALITY CHAMPIONS OF THE WORLD

GINI-coefficient in selected OECD-countries, mid-2000s, 0 = Total equality; 1 = Total inequality

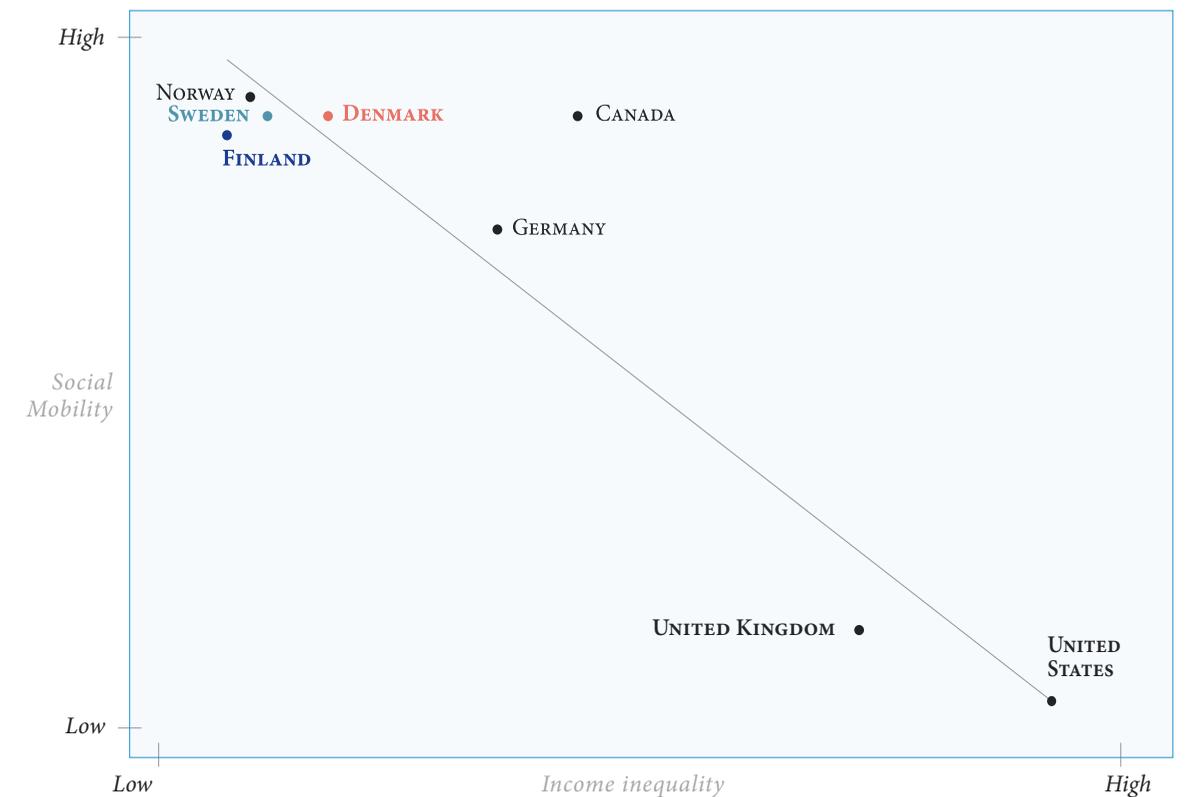


The Nordic countries have some of the most equal societies in the world. Denmark and Sweden takes the two top positions and Finland doesn't trail too far behind.

Source – OECD.

### THE AMERICAN DREAM IS NORDIC

Social mobility and income inequality



Both Social mobility and income equal is high in the Nordic countries. This shows that is much easier to live out the American dream in the Nordic countries than in the United States or the United Kingdom

Kilde – Wilkinson and Pickett: The Spirit Level: Why More Equal Societies Almost Always Do Better, 2010, p. 160

in recent years with countries struggling to learn from each other. A culture of entrepreneurship is not currently the Nordic countries' strongpoint. All of the countries are calling for more entrepreneurship, innovation and risk taking from start-up companies and those around them.

In Finland, for example, the national innovation system works on several levels with both national and regional

actors. The Finnish Prime Minister is the head of the Research and Innovation Council. World class education and talent development is a crucial basis for Finnish innovation policy. High priority given to elementary school education and a close collaboration with universities make the basis of the Finnish educational system very solid.

It is widely acknowledged by the Nordic countries that

small countries have to take an active approach to gain knowledge on future markets, trends and challenges – new sectors and new innovation strategies must be detected and investigated quickly.

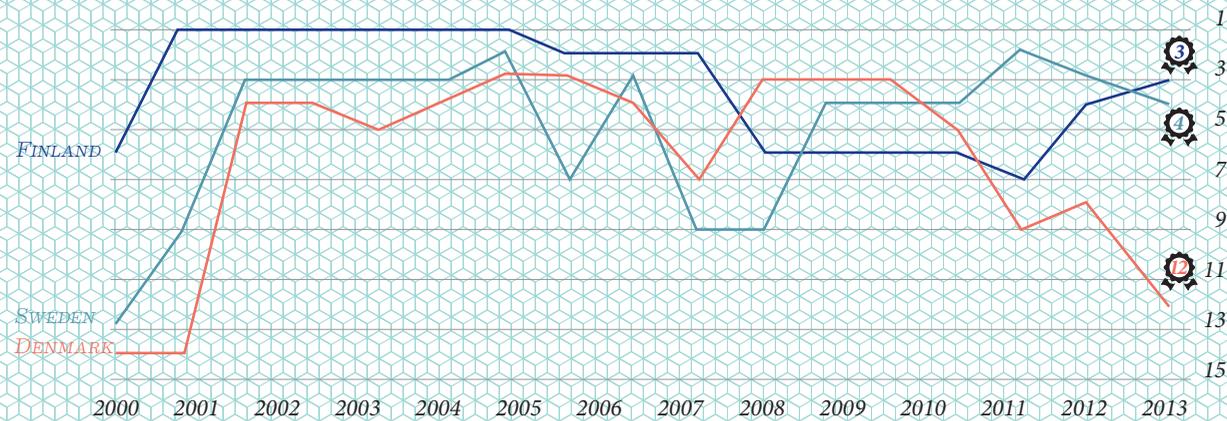
in Finland, a national conversation about the country's most important contribution to solving major global challenges has been executed with broad participation and

with an output of specific missions to a broad group that extends beyond academia and industry. The key Finnish missions are to apply functionality, sustainability and education to the problems of tomorrow.

The Nordic economies are all highly competitive and have been ranked by the World Economic Forum to be among the top 10 most competitive economies in the world since the early 2000s. In their 2013 ranking Finland was placed 3rd, Sweden 4th and Denmark 12th out of 141 countries surveyed.

**NORDIC COUNTRIES' COMPETITIVE DECADE**

Rankings of the Nordic countries in the Global Competitiveness Index, 2000-2012



Source - World Economic Forum (2012)

**“The Nordic countries exemplify an intense, open and innovative enterprise culture with some of the most egalitarian social and civic cultures in the world. In doing so, they point to the crucial role of public infrastructure and leadership in underpinning the creative economy.”**

RICHARD FLORIDA, BEST-SELLING AUTHOR AND LEADING INTELLECTUAL ON BUSINESS AND COMMUNITY TRENDS.



**KNOWLEDGE ECONOMY INDEX**

109 structural and qualitative variables measures 146 countries' performance on four Knowledge Economy pillars. Sweden, Finland and Denmark top the World Bank's ranking.

1. SWEDEN
2. FINLAND
3. DENMARK
4. NETHERLANDS
8. GERMANY
11. USA
14. UK
22. JAPAN

Source - World Bank



**GLOBAL INNOVATION INDEX**

INSEAD and the World Intellectual Property Organization co-publish this index measuring innovation performance, rating the Nordic countries among the most innovative in the world.

1. SWITZERLAND
2. SWEDEN
4. FINLAND
5. UK
7. DENMARK
10. USA
15. GERMANY
25. JAPAN

Source - Rating of 141 countries by INSEAD and WIPO, 2012.



**GLOBAL CREATIVITY INDEX**

By assessing the prospects for sustainable prosperity with a focus on "Technology, Talent, and Tolerance", the Martin Prosperity Institute ranks the Nordic countries at the very top.

1. SWEDEN
2. USA
3. FINLAND
4. DENMARK
13. UK
15. GERMANY
15. FRANCE
30. JAPAN

Source - Rating of 82 countries by Martin Prosperity Institute, 2011.



**EASE OF DOING BUSINESS**

The World Bank's rating averages 10 topics to assess to what extent the national regulatory environment is conducive to the starting and operation of a local firm.

1. SINGAPORE
4. USA
5. DENMARK
7. UK
11. FINLAND
14. SWEDEN
19. GERMANY
20. JAPAN

Source - Rating of 185 countries by World Bank, 2012.

ARTICLE 4

# THE FUTURE OF THE NORDIC MODEL

## – Facing challenges, staying competitive



What challenges do the Nordic countries face? And what is being done to ensure long-term economic sustainability?

The Nordic Model has proven its viability in recent decades. But its success cannot be taken for granted in the years to come. History shows that continuous reforms are necessary for the model to survive, and this is more than ever the case today.

According to three leading experts in the Nordic countries' economies, the three countries face demographic changes, a possible future shortage of labour and growing global competition. The three experts argue that these challenges must be met to ensure long-term economic sustainability.

- **CHALLENGE 1:** Public deficits and debt must be kept under control.
- **CHALLENGE 2:** The Nordic countries must cope with an ageing society.
- **CHALLENGE 3:** It is crucial to stay competitive in the global economy.

The Nordic countries are already addressing these challenges, and the economic experts believe that the three countries have a strong foundation. Their track records also prove that they are capable of making profound structural changes to adapt to major challenges and ensure economic sustainability.

### A SOLID FOUNDATION

Experts believe that the Nordic countries have a stronger foundation than most other countries when it comes to ensuring economic sustainability. This is due to the countries' histories of reforming and adjusting their economies.

“Sweden made a lot of reforms during the financial crisis in the 1990s, and today we can see the results. The prospects are good, but we need to keep on our toes. One of Sweden's greatest competitive strengths is that long-term economic sustainability has been ensured though fiscal reforms, e.g. the reform of the pension system and the new fiscal policy framework,” says John Hassler, professor of Economics at Stockholm University and Deputy Chairman

### LOW DEBT

Total central government debt, percentage of GDP

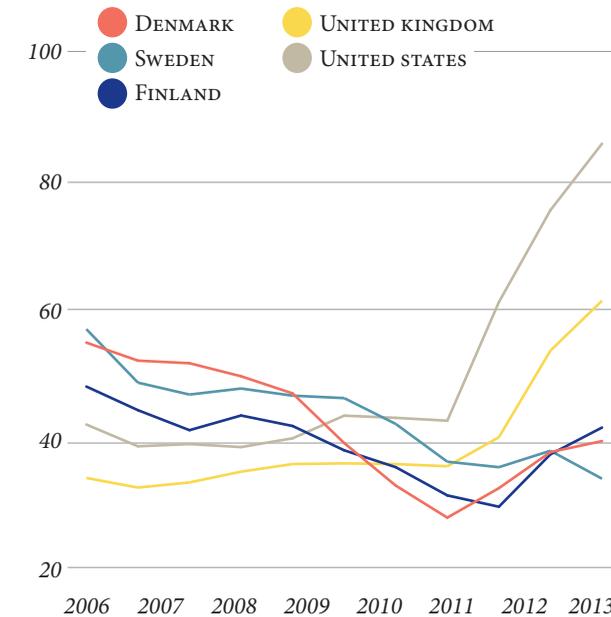


FIGURE 1 The government debts in Finland, Sweden and Denmark are relatively low.

Source – OECD

### BALANCED BUDGETS

Net lending/net borrowing as a percentage of GDP, surplus (+), deficit (-)

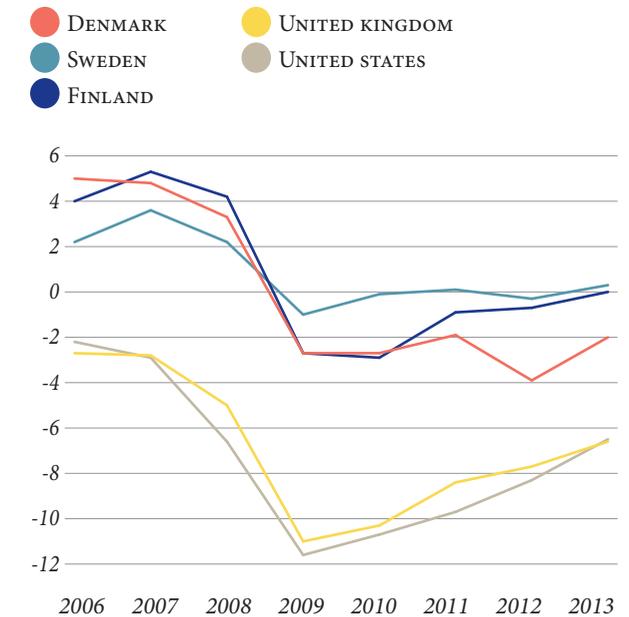


FIGURE 2 The lending and borrowing is under control. The estimate is that the countries will improve their balance further.

Source – OECD 2012

of the Swedish Fiscal Policy Council.

Danish professor in Economics at Aarhus University in Denmark Michael Svarre is also generally optimistic about the outlook for Danish economy.

“The Danish economy is generally well-organised. Things are under control and Denmark is on the right track. Retirement reforms, lowering of income taxes and a tax deduction for being employed will help increase the labour supply. More people on the labour market will prevent wages from rising, thereby increasing competitiveness,” Svarre says.

Finnish governments have hesitated to make the much needed retirement and labour market reforms, says Juhana Vartiainen, Director General of the Finnish Government Institute for Economic Research.

“The Finnish government has been less proactive in dealing with this challenge than the Swedish and Danish governments. Some moves towards labour-supply reforms have been made, but these have been marginal and timid. The Finnish government needs to make reforms of the retirement age and get rid of the early retirement scheme

for elderly unemployed citizens,” he says.

Vartiainen stresses that the challenges facing the Finnish economy are manageable and he underlines the Finnish tradition of making the necessary reforms.

“If the next administrations deal with the sustainability gap then the outlook for the Finnish economy is good. Finland is an open economy with an excellent education system. There is no reason why we shouldn't be a successful competitive economy. And if you look at our track record, it is positive. Finland – along with the other Nordic countries – has always dealt with our problems,” Vartiainen concludes.

### MANAGEABLE DEBT AND DEFICITS IN THE CRISIS

Like most western countries Denmark, Finland and Sweden are affected by the financial crisis. The crisis entails a serious challenge to the foundation of the Nordic Model with its large public sector and high levels of redistribution.

The financial discipline of the three countries has enabled them to control public spending and debt levels. >

### MORE UNEMPLOYED – FROM RECORD LOW NUMBERS

Unemployment rate, percentage of workforce

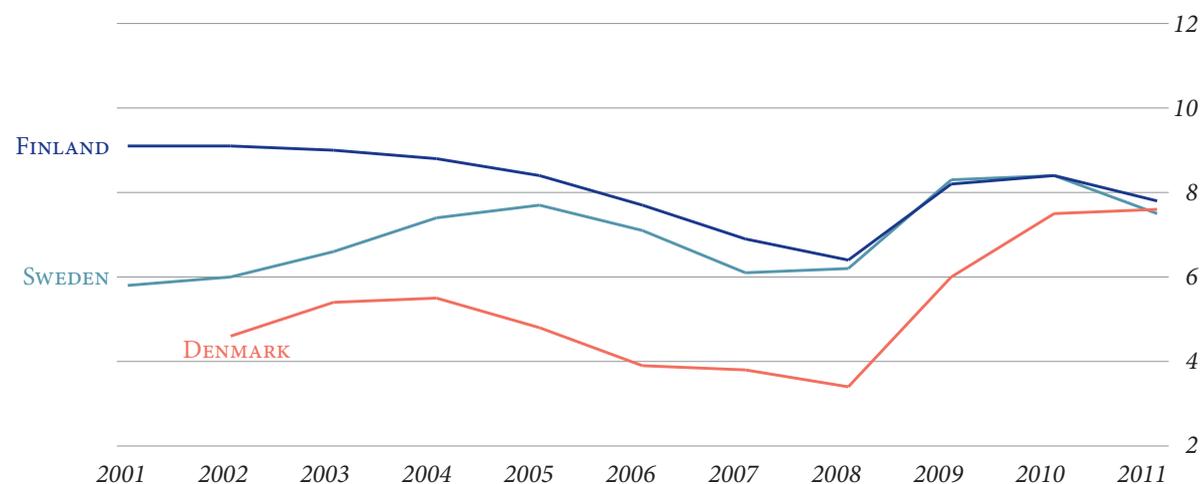


FIGURE 3 The unemployment rates in Denmark, Finland and Sweden have been rising in recent years, but this development seems to have been halted.

Source — Eurostat.

### THE DEVELOPED WORLD IS GROWING OLD

Elderly population (aged 65 and over) as a percentage of total population.

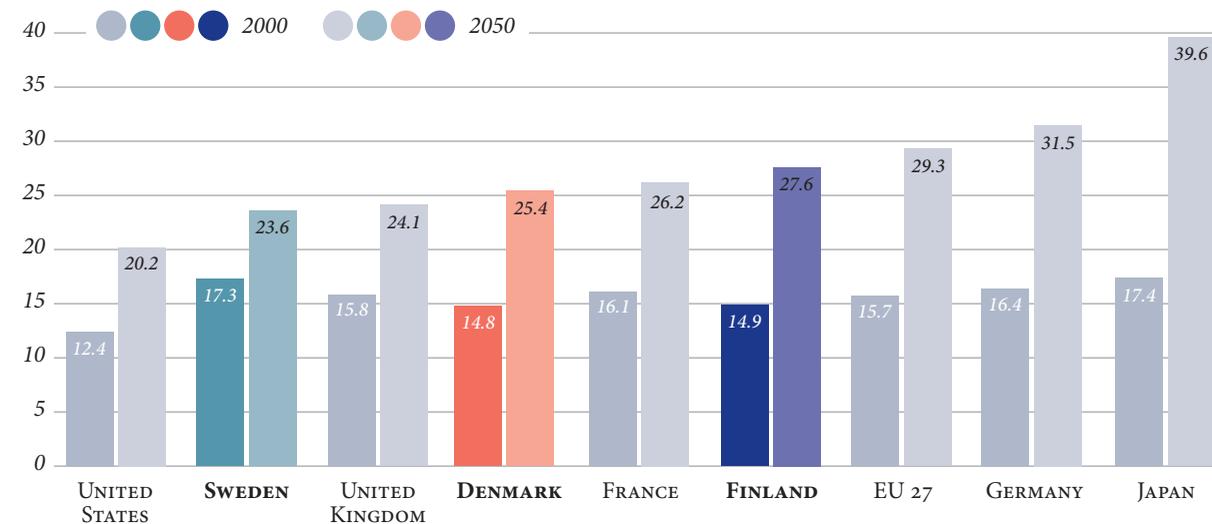


FIGURE 5 The world is getting older, but less so in Denmark, Finland and Sweden than in other countries.

Source — OECD Factbook 2010: Economic, Environmental and Social Statistics.

### AVOIDING A LOST GENERATION

Unemployment rate, people under 25

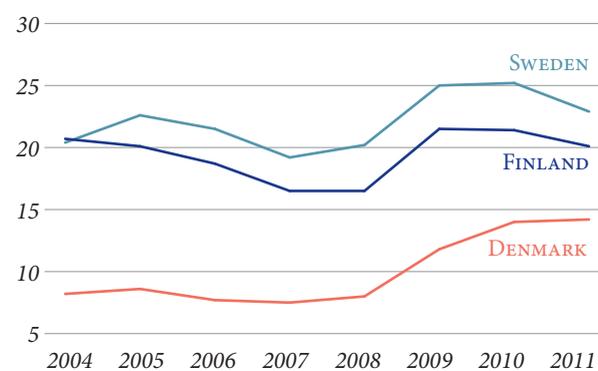


FIGURE 4 Particularly alarming is the fact that the youth unemployment rates in Denmark, Finland and Sweden are on the rise.

Source — Eurostat.

*“It is a fundamental challenge that the three countries are currently oversupplied with labour, whereas in a few years the countries will face a shortage of labour because older generations will be leaving the labour market.”*

Government debt is still among the lowest of the OECD countries, and the countries have managed moderate public deficits through the crises. See figures 1 and 2.

Even though Denmark, Finland and Sweden have coped pretty well with the financial crisis, unemployment rates have risen, especially among the young. With unemployment the Nordic societies lose tax revenues and face rising social expenditures as the model provides generous social benefits for the unemployed.

Denmark in particular has seen rising unemployment rates – from a record low to a level that matches both Finland and Sweden at around 7-8 percent. See figure 3.

Youth unemployment rates have risen as a result of the financial crisis, although less so than in other countries. See figure 4.

Political debate centres on how to avoid a “lost generation”. It is a fundamental challenge that the three countries are currently oversupplied with labour, whereas in a few years the countries will face a shortage of labour because older generations will be leaving the labour market. The skills needed for future jobs are a highly debated subject, and calls for a greater focus on education can be heard in all countries.

### DEMOGRAPHIC CHALLENGES – A LABOUR MARKET CHALLENGE

Societies around the globe face similar challenges with ageing populations. The demographic shift leads to fewer tax revenues and increased expenditures for pensions, health care, etc. This puts increasing fiscal pressures on public sectors all over the world, including those in Finland, Sweden and Denmark.

The three Nordic countries all face rising shares of dependent elderly citizens. OECD estimates that in 2050 23.6 percent of the Swedish population will be aged 65 or more as opposed to 17.3 percent in 2000. In Finland the proportion is likely to rise from 14.9 percent to 27.6 percent and in Denmark from 14.8 percent to 25.4 percent. See figure 5.

But the demographic challenges in the Nordic countries are still manageable compared to most OECD countries. 39.6 percent of the Japanese population will be over 65 years old in 2050.

Denmark, Finland and Sweden have already made several reforms to their pension systems in order to address the demographic challenge. All three countries have been heading towards an automatic adjustment of the retirement age to reflect developments in life expectancy as a way of >

### HIGH FERTILITY RATES

Children per woman in selected OECD countries.

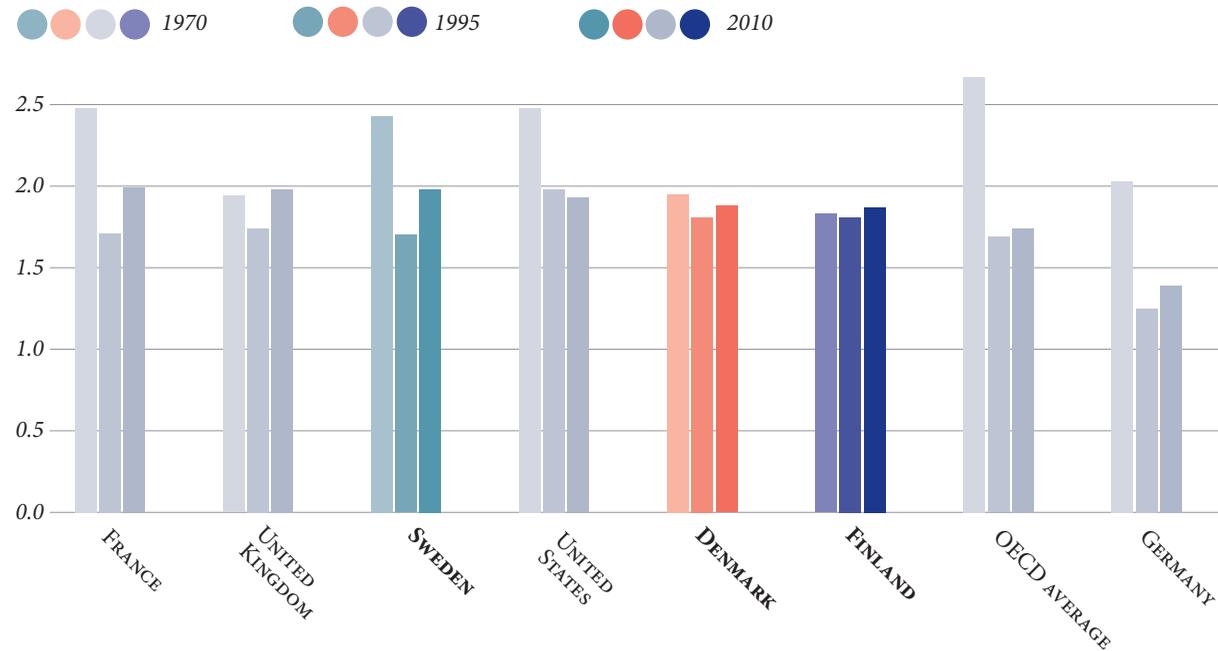
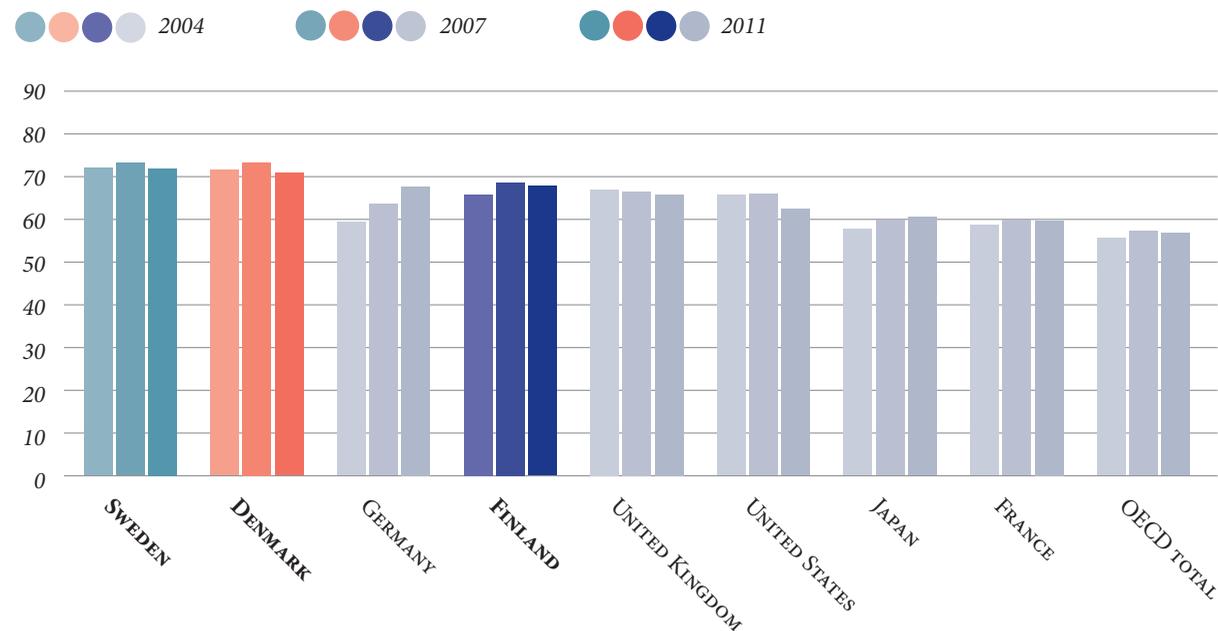


FIGURE 6 The fertility rates in Denmark, Finland and Sweden are modest but stable.

Source — OECD (2011): OECD Family Database. OECD, Paris.

### NORDIC WOMEN AT WORK

Employment rate of women, % of female population (15-64)



### NORDIC CITIZENS AT WORK

Employment rate, percentage of working age population

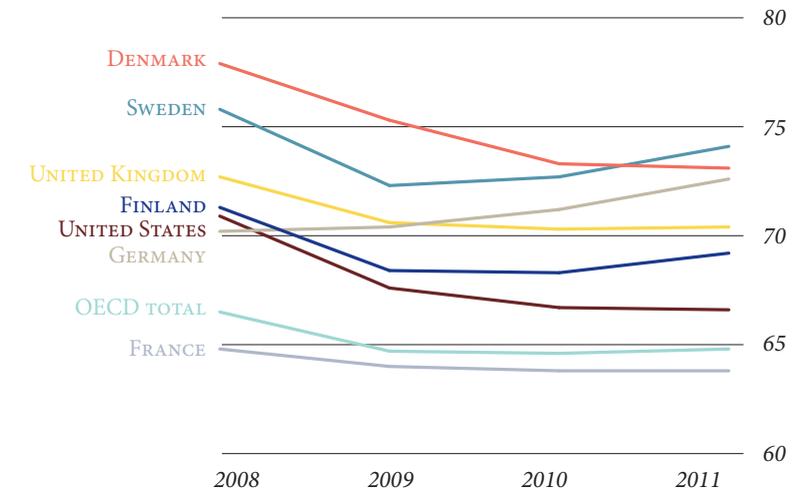


FIGURE 8 Denmark, Finland and Sweden have some of the highest employment rates in the world despite falling employment rates due to the crisis.

Source — Labour market statistics: Labour force statistics by sex and age: indicators, OECD Employment and Labour Market Statistics (database).



tackling this sensitive political issue.

Denmark, for example, made the retirement age ‘fluid’ in 2006. This means that the retirement age for public pensions will be linked to life expectancy from the mid-2020s onward. Early retirement schemes have also been abandoned. The Swedish pension system has also been subject to major reforms. Finland, on the other hand, still has some way to go in order to address the demographic challenges, according to leading economists in the three countries.

Another demographic trend in most developed countries is declining fertility rates. Although the fertility rates in the Nordic countries are modest – i.e. below two children per woman on average – they have been rather stable and are among the highest in Europe along with those of France and the UK. See figure 6.

Interestingly, the Nordic countries have managed to combine these relatively high fertility rates with some of the highest employment rates for women in the world Denmark (71 percent), Finland (67 percent), and Sweden (70 percent) are all well above the OECD average of 57 percent. See figure 7.

Extensive family policies such as day care and maternity

leave schemes make it possible to start a family without one of the parents having to leave the workforce and give up their professional career.

Another way the Nordic countries are trying to address the problem of labour shortage is through migration policies. The Nordic countries have all faced difficulties in integrating foreigners successfully and attracting skilled workers from abroad. The three countries still trail other countries in this area.

In order to improve the efforts to attract more skilled immigrants, all three countries offer introduction programs for immigrants including language courses and general information about the society. The programs are mandatory in Denmark and Finland and voluntary in Sweden. Empirical tests in Finland indicate that the impact of programs as such on labour market performance is considerable. Denmark has increased international recruitment efforts by marketing itself as a potential future workplace and relaxing residency requirements for qualified foreigners. In 2010, Sweden introduced a reform which involved early measures to help newly arrived immigrants to settle in order to generate shorter spells of unemployment among the immigrants.

## EXPENSIVE PRODUCTION

Production cost of labour per unit of output. Index with 2005=100.

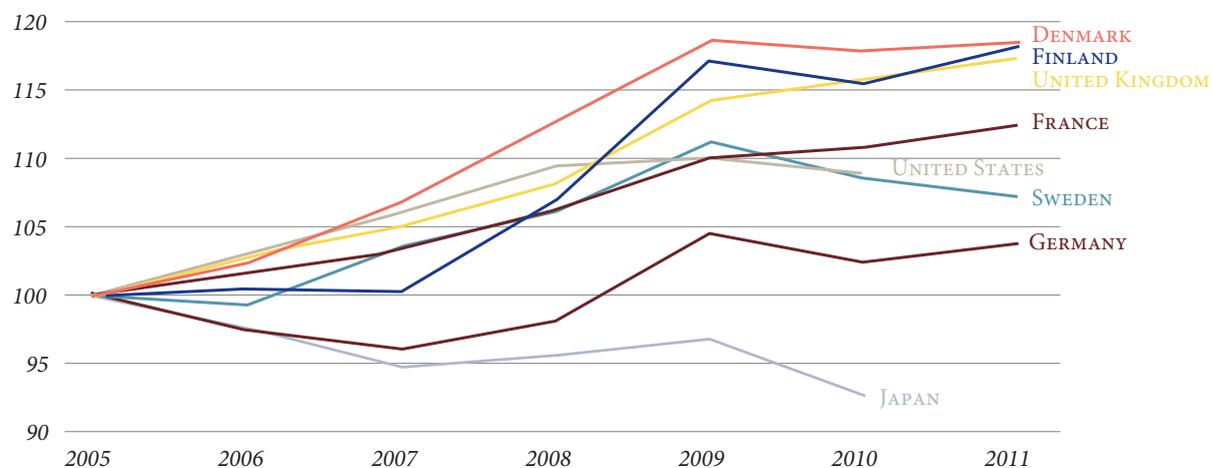


FIGURE 9 Production costs are rising in Denmark, Finland and Sweden.

Source — OECD Index.

## THE ANSWER TO THE DEMOGRAPHIC CHALLENGES: REFORMS

Despite the abovementioned reforms of the pension systems, forecasts still predict declining working populations in the Nordic countries. Therefore a major challenge is to prevent a future shortage of labour and create a reasonable balance between the working and non-working groups of society. The basis is solid, with the Nordic countries having some of the highest employment rates in the OECD.

A number of labour market reforms have been made in the Nordic countries since 2000 to ensure economic sustainability and competitiveness. See box 1.

Reforms have targeted traditional issues such as incentives to work and tax policies. An active labour market policy has also been introduced. The aim is to ensure that the unemployed are not just passively receiving benefits. The goal is both to upgrade the qualifications of the unemployed and at the same time demand that they continuously apply for jobs.

## STAYING COMPETITIVE IN THE GLOBAL ECONOMY

Outsourcing of jobs from the Nordic countries to low wage areas like China, India and several Eastern European countries has increased with globalisation. Unskilled

workplaces have disappeared from the Nordic labour market, and recently the number of skilled jobs being off-shored to countries such as India has risen. How will the Nordic countries be able to retain an employable workforce and competitive and innovative businesses despite the countries' relatively high wage levels? This question occupies politicians and citizens.

Denmark and Finland in particular have experienced rising costs of production in recent years. This is a major competitive challenge.

“Currently the biggest challenges for the Danish economy are high wage levels, low productivity levels and a strong currency,” says Danish professor Michael Svarre.

The same goes for Finland: “Up to 2007 the outlook for Finnish competitiveness was very positive. Finland had a better unit-labour cost ratio than most of the other European countries. However from 2008 the Finnish unit costs have risen markedly. This is due to poor productivity growth and wage increases. Wage moderation used to be a key-asset for the Finnish economy but the labour market parties are having more problems agreeing on overall wage levels,” says Professor Juhana Vartiainen.

The experts agree that labour market reforms can boost competition in the three countries.

“The reforms will help reduce the Danish production cost >

### BOX 1

## LABOUR MARKET REFORMS SINCE 2000

### DENMARK:

Major initiatives:

- 2006: Intensified and earlier activation for unemployed
- 2007: Creation of local government ‘job centres’
- 2008: Adult apprentice scheme
- 2009: Transfer of the state and regional job centre functions to the local governments
- 2010: Period of unemployment benefits reformed

Challenge: Falling numbers in the workforce

### FINLAND:

Major initiatives:

- 2001: Reforms supporting job searching and/or preventing and tackling long-term unemployment
- 2005: Higher unemployment benefits while taking part in active labour market policies and intensified activation
- 2006: Introduction of Labour Force Service Centres to tackle long-term unemployment

- 2010: Self-motivated education and training for unemployed people (2010)

Challenge: The retirement age and youth unemployment

### SWEDEN:

Major initiatives:

- 2007: Jobs tax deduction, new-start jobs
- 2008: Increasing the incentives for unemployed to break from unemployment, e.g. introduction of unemployment levy
- 2009: Increased funding for adult education
- 2010: Testing of people with work ability after three months in the insurance system and individualised labour market measures to determine the need for support for a transition to work

Challenge: Rising numbers of young unemployed people with short educations

## MIDDLE OF THE PRODUCTIVITY ROAD

GDP per hour worked, US dollars, current prices and PPPs, 2010

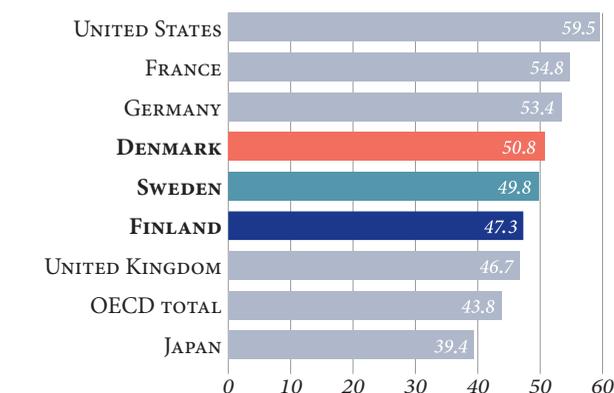


FIGURE 10 The Nordic countries are average performers when it comes to levels of productivity. GDP per hour worked, selected OECD countries

Source — OECD Factbook 2011-2012: Economic, Environmental and Social Statistics.

## MODEST GROWTH IN PRODUCTIVITY

Labour productivity growth in the total economy

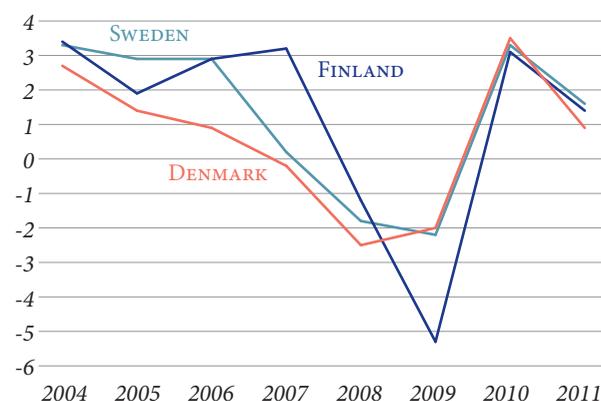


FIGURE 11 Even before the crisis, Denmark and Sweden experienced falling growth in productivity. Therefore the question remains a central concern to economic policy in all three countries.

Source — XXX.

## MORE INNOVATION, PLEASE

Proportion of innovative enterprises, 2008 (percentage of all enterprises)

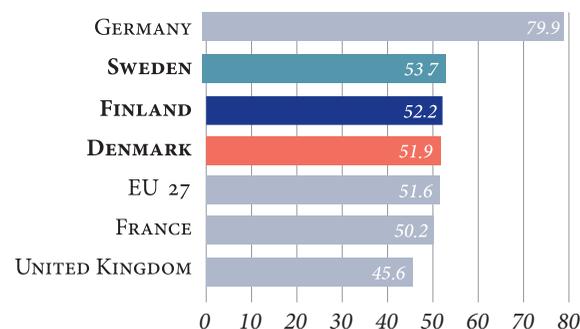


FIGURE 12 There is room for improving the innovation capacity of Nordic companies.

Source — Eurostat.

“Through the history the Nordic countries have always managed to deal with their problems.”

JUHANA VARTIAINEN, DIRECTOR GENERAL OF THE FINNISH GOVERNMENT INSTITUTE FOR ECONOMIC RESEARCH

### BOX 2

## A STRONG TRACK RECORD

“THROUGH HISTORY THE NORDIC COUNTRIES have always managed to deal with their problems,” says Juhana Vartiainen Director General of the Finnish Government Institute for Economic Research.. Not only have they previously come up with new ideas, but they have also been ready to make tough choices in order to ensure economic sustainability.

Recent history is a testament to this track record: Denmark, Sweden and Finland all experienced economic crises in the 1980s and 1990s, but managed to bring their economies back on track through tough reforms. These reforms have helped make the Nordic societies economically sustainable, and the success of the Nordic economies in recent years is largely due to the crisis management of the 1980s and 1990s.

### FINLAND

In the early 1990s the entire Finnish financial sector suffered a deep crisis after several years of a debt-based economic boom in the late 1980s. The financial market was deregulated, leading to a massive credit expansion largely based on foreign debt. This created a bank crisis and gave rise to the name ‘kasinotalous’ or ‘casino economy’. At the same time the collapse of the Soviet Union meant that Finnish export to the USSR fell from approximately 30 percent in the 1980s to only 5 percent in 1993. The Finnish GDP decreased by 13 percent and unemployment rose from 3.5 percent to almost 20 percent in just three years. Governmental bank takeovers, direct monetary assistance and temporary guarantees to banks helped solve the banking crisis, and a period of tight fiscal policies with cut backs on both central and local government expenses restored the economy. Finland’s export-led economy grew fairly quickly after the crisis.

### DENMARK

Denmark used to have the most troubled economy in the Nordic area, suffering both from inflation and high unemployment. In the 1980s, interest rates rose to more than 20 percent and national debt ballooned drastically. A number of tough austerity programmes in the 1980s – notably the “potato cure” – stabilised the economy, and in 1986 the country achieved a public budget surplus for the first time since 1975.

Denmark joined the European Union in 1973, far ahead of Finland and Sweden, and decided early on that a fixed currency was necessary to overcome inflation and lack of economic policy credibility. In 1982 the Danish Krone was pegged to the D-Mark and today to the euro. This laid the grounds for economic recovery.

### SWEDEN

In the early 1990s Sweden suffered from high interest rates to protect a fixed exchange rate. Deregulation in the Swedish financial sector had led to a credit expansion based in growing real estate prices that overheated the economy and caused inflation to rise, competitiveness to drop and the deficit to grow. Interest rates went up, GDP levels dropped, unemployment rose from 1.7 percent in 1990 to 8.2 percent in 1993 and an economic crisis was a reality. The budget deficit peaked at 12 percent of GDP, and the central bank’s key interest rate peaked at 500 percent while unemployment quadrupled. The Swedish government tightened the fiscal policies though cutbacks in the public sector and instituted a multitude of reforms to improve Sweden’s competitiveness.

Against these past crises, the present challenges seem more manageable, and the Nordic countries have rarely been better equipped for the future than they are today.

by increasing the labour supply. More people on the labour market will prevent wages from rising, thereby increasing competitiveness. At the same time wage levels are rising in Asia and in Germany. This will make Denmark more competitive,” Michael Svarre explains.

The financial crisis meant negative growth in Denmark, Finland and Sweden. Growth in productivity is a prerequisite for continuing economic growth and a key challenge for the Nordic countries. The present productivity rate is close to the OECD average – something the countries are determined to improve. See figure 10.

Even though the countries have seen a rise in productivity growth, some economists are worried about the stagnation in growth even before the crisis. Therefore the three countries are focused on productivity as a political priority. See figure 11.

“Raising productivity levels is a long-term challenge that has to do with education policies, research policies and industrial policies. We have to create the best possible

conditions for our companies to stay competitive,” Michael Svarre says.

John Hassler agrees: “Education is a key factor in ensuring future competitiveness, but I fear that the large expansion of the higher educational system has been at the expense of lower quality,” says the Swedish professor. He emphasises the need to keep focus on education in order to maintain productivity. The number of university students is rising fast, making it difficult to ensure high quality, he points out.

Growing global competition and somewhat moderate productivity levels have increased political awareness of how to enhance the innovation capacity of companies in Denmark, Finland and Sweden. In 2009 Finland introduced a new national innovation strategy. Similar strategies are due to be launched in both Denmark and Sweden in 2012. The three countries are already performing above the EU average, but still feel they can improve in this respect. See figure 12.

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**THE NORDIC MODEL  
- LOCAL WELFARE, GLOBAL COMPETITIVENESS IN  
DENMARK, FINLAND AND SWEDEN**

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