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Working Paper No. 2010/116

The Nordic Development and Growth Models

The Riddle is Still There but We May be a
Little Bit Wiser

Juhana Vartiainen

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Abstract

The Nordic countries are often bundled together, as representatives of a ‘model’ which combines high living standards and an open market economy with social insurance and ambitious public services. Yet, the economic and political development of Denmark, Finland, Norway and Sweden towards this model has taken quite different roads. Sweden’s economic development from the late nineteenth century onwards can be seen as a rather spontaneous industrial breakthrough, whereas the state has in both Norway and Finland assumed a more active and interventionist role in mobilizing resources and managing natural endowments. However, the four countries are quite similar in their acceptance of the market economy, technical progress and economic openness, coupled with a pursuit of equality and a state that has alleviated resistance to change by signalling a will to share the gains and losses due to structural change.

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1 Four utterly different catchwords

The Nordic countries are often bundled together in international scholarly discussions and policy debates. Yet, any student of the fine print of these countries' economic and social policies is struck by the diversity of the policy experiences. The four Nordic country papers (please see the references) have outlined some salient aspects of each country's growth outcome. The very diversity of the points of view of the four Nordic country papers underlines their diversity: instead of going through similar variables and similar time spans for all the four country cases, the papers take completely different point of views.

Sweden seems to come close to a textbook example of a *spontaneous capitalistic breakthrough*: individual companies working in congruence with a benevolent and rational state power to increase productivity and mobilize resources. Although aided by more ancient historical traditions, this industrial breakthrough started in the late nineteenth century, with an interplay of technological innovations, investment, educational reforms, and legislative efforts. Thanks to investments in human capital, technological innovations, and attractive export markets, Sweden provided fertile ground for the growth of many large industrial companies. Later on, the very logic of capitalistic development created a demand for a welfare state: households dependent on wage income were much more vulnerable to market uncertainty and shocks than what had been the case in the agrarian society in which the extended family unit provided for the basic material needs of household members at all times.

Norway was from the outset of the industrial era a less diversified economy, more dependent on some key industries and raw materials bases: the shipping, shipbuilding, fishing, and metalworking sectors in particular. From the 1970s onwards, Norway entered an era in which one particular raw material resource—oil—drove the economy towards a much higher level of income. Thus, the Norwegian 'big picture' has to do with the *management of a large natural resource base*, from which various backward and forward linkages have sprung.

Finland, in turn, managed a remarkably rapid mobilization of resources and the accumulation of physical industrial capital in the post-Second World War period. This remarkable catching-up was achieved by quite interventionist means: public and forced saving, outright economic planning, the creation of publicly-owned companies, selective industrial policy plus the rationing of credit to manufacturing sector capital investment at the expense of households' consumption needs. This growth regime is reminiscent of the Asian tiger cases and a catchword for the Finnish growth regime could as well be an *interventionist developmental state of the Asian type*.

Finally, **Denmark's** economic growth story combines elements of a natural resource base—agricultural products—with a spontaneous development of small and middle-sized companies, aided by farmers' cooperative efforts as well as a strive to educate and enlighten the broad masses of citizens. Danish manufacturing and service industries grew spontaneously like the Swedish ones, but did not proceed by large investment projects undertaken by big companies. Rather, Denmark became a *spontaneously organized society of small businessmen*.

The diversity of these catchwords suggests that the success of the Nordic experience cannot really fit into many classic political controversies about economic development. Take the classical ideological controversy of whether economic growth is best advanced by spontaneous market forces or government laissez-faire. Well, the Nordic examples include the spontaneous market-driven development model of Sweden, as well as the almost planned economy managed by the Finnish developmental state. Or, to take another example, there is a discussion about the implications of a large national resource base, which in the case of many countries has obviously had adverse effects for societal development: too few resources are devoted to the diversification of the economy, and too many political resources are devoted to the division of the extraction rent. Again, as convincingly argued by the authors (Cappelen and Mjøset) of the Norway paper, Norway does not fit this pattern at all: with appropriate institutions, a national raw material can be managed to the benefit of the entire society. Inspired by the Norwegian example, the authors of the Norway country paper present an econometric analysis that suggests that a prominent raw material base, when coupled with good economic institutions, benefits an economy.

A third example would be the role of social cohesion and social capital. Many policymakers and scholars believe that social capital and cohesion is one ingredient of successful economic development. Yet, look at Finland, which underwent an extremely violent civil war in 1918, just a couple of decades before its large-scale industrial tradeoff, and where society, even after the civil war, was bitterly divided along the same ideological cleavages.

Finally, a fourth example would be the role of ‘high-tech’, resources devoted to designing new and advanced technologies as well as the effort to commercialize them—all themes that are often investigated in new growth theory studies are often regarded as preconditions for strong economic growth. Denmark is a good example as it has achieved high employment and productivity without major investments in big high tech projects. Instead, as explained in the Denmark paper (by Lundvall), the country’s success may be more due to promoting lifelong individual learning and social skills, whereas the share of low-tech industries in Danish manufacturing value added has traditionally been quite high.

2 What unites the Nordic countries?

One possible conclusion of this diversity experience is that scholars should simply stop grouping the Nordics countries together, and that is certainly one possible way of looking at the Nordic experience. Yet, we would like to suggest at least some common characteristics. Listing them does not amount to any theory of Nordic economic development, but may at least be a starting point for further discussion. We would like to present them as five ‘slogans’ that resonate in the Nordic political culture.

2.1 Yes, to both Marx and Adam Smith

It is often thought that an efficient market economy and a public economic sector that obeys another logic must compete of the same ‘space’ in society. The Nordic experience suggests that successful societies must have a lot of both. A powerful civil society underpinned by publicly-owned resources is a precondition of a successful market

sector and a successful market sector is a precondition for a strong civil society and public sector.

The Nordic countries, and Sweden in particular, are often labelled just as ‘socialist’. Yet comparisons of institutions reveal that the Nordic economies are in many respects quite market-oriented and market-driven economies, especially when compared to other European countries. For example, product market regulation is very weak in European comparison, the financial systems are quite efficient, and even employment protection is on average weaker than in the large European Union countries (see Andersen et al. 2007). Thus, although the level of taxes is high, the Nordic economies are otherwise quite effective markets societies.

Side by side with a market economy, there is a large public sector that does what public sectors do well: education and healthcare. The Nordic countries have in international comparison, quite ‘socialistic’ school systems. All children are expected to undergo a public primary school system of nationally established standards of typically nine years and there is very little ‘tracking’ of pupils before high school. This has probably implied a remarkable equality of opportunity. A positive example is Finland, in which the correlation of parents’ economic performance with that of their children collapsed to an altogether lower level after the introduction of a comprehensive and unitary primary school system (see Pekkarinen et al. 2009).

Healthcare systems are the other main sector that the public sector mostly takes care of. It is well-known from international comparisons that public health systems tend to produce good health outcomes with the least outlay of resources. For example, investing in ex ante prevention of diseases instead of expensive treatments is something that can be economical for a society, yet hard to square with the incentives of private healthcare providers.

2.2 All men and women are born equal

Thanks to earlier land reforms and the weakness and absence of feudalism, a culture of equality has permeated the Nordic societies. The idea of hereditary or other forms of elites is alien to Nordic citizens, and this idea even extends to attitudes towards gender equality. A less than full economic citizenship is not acceptable for women, and this has implied female labour market participation rates that are high by international standards. It has not prevented a segregation of the labour market into male- and female-dominated industries and sectors, but it has probably increased the aggregate level of economic resources. Some public services like childcare clearly boost the overall labour supply of both men and women.

The role of school systems was emphasized above. Education, however, has in the Nordic countries also been understood as emancipation towards full citizenship, a result of many national movements that arose in the nineteenth century to organize civil society: the temperance movement, the national sports leagues, the various free and confession churches, and of course the social and political movements that, to a higher degree than what is generally appreciated, were movements of enlightenment and emancipation for workers and farmers. The social democratic labour movements were to a large extent self-educational movements, but so were farmers’ cooperatives already in the nineteenth century, as emphasized in the Denmark paper. This tradition has

contributed to a culture of lifelong learning, with the promotion of vocational free universities and civic academies.

The egalitarian ideals have also contributed to the creation of a welfare state that is universalistic: many benefits are available on equal terms to all citizens and even all residents. Thus, as explained in the Sweden paper, it has often not been necessary to identify those groups that are particularly vulnerable. This has mitigated polarizing conflicts between those who contribute to and those who consume welfare services and income transfers. Furthermore, most citizens have both roles during their lifespans, which has reinforced the political support of the welfare state and thereby the willingness to pay taxes.

2.3 Resources have to be managed to the benefit of the entire nation

When in ownership of large natural resources, the Nordic nations have to a large degree regarded such resources from a national and nationalistic perspective. The state has taken an active interest in the development of resource extraction. For the Swedish and Finnish forest sectors, as explained particularly well in the Sweden paper, national ‘forest management’ became a key policy area. This had to do with planning for a continuous renewal of the resource in order to prevent its depletion, as well as establishing public-private partnerships around research and training institutes that contributed to the design of new exploitation and processing techniques. To some extent, this national forest management presupposed limiting the choices of the private forest owners—in Sweden, all forest owners are required to prepare a forestry plan—but it need not amount to any full-scale nationalization. Thus, a government should not confiscate the resources, but the resource owners should not hijack the government either.

The prime modern example of a successful management of a big national resource base is the Norwegian oil. In the Norwegian case, there were antecedents to this, and the Norway paper by Cappelen and Mjøset explains how a nationally-oriented and politically conscious bourgeois elite managed to keep national control of resources vital to the economic development of the country already a hundred years ago. The idea of a national control over resources was firmly rooted when oil became, from the 1970s onwards, a new and major source of wealth. As described in the Norway paper, discussions on how to develop a more robust oil policy in response to fluctuating oil prices led to the establishment of a Petroleum Fund in 1996. The fund invests government oil revenues in international assets, and the country has since then adopted a policy according to which only a fixed return of the fund will each year be used by the government. This rule secures that petroleum wealth is not consumed but converted into a pool of financial assets that can help to secure a generous welfare state in the future.

2.4 Be moderately nationalist and have confidence in the nation’s future

The Nordic papers also make clear that all the Nordic growth and development regimes have been able to establish a positive belief that life will become better and investments will pay off. This has been true of all the countries and all the periods that the country papers explore, and it has underpinned both learning and incentives for investment in physical productive capital. This need not always have been associated with a generally optimistic and sunny mood. As described in the Finland paper, the external constraint may have worked through the scarceness of any alternatives to rapid industrialization,

but it did work. In all the Nordic countries, the rule of law has been strong and the political system has strived to create predictability in economic policy. For exporters in Finland and Sweden, for example, the soft exchange rate policy—although ultimately unsustainable when financial markets were liberated—was a reminder that the state was committed to the profitability of the export industry.

2.5 Be positive to economic openness and new techniques, but share the risks and the gains

Finally, and most importantly, all the Nordic countries have espoused economic openness and technological progress. The labour movement has never had any Luddites, and the protectionist lobby has been weak (farming is an exception, however). Most economists would regard this as a self-evident necessity for small economies with a high degree of specialization: the domestic market would never be sufficient for wealth creation. However, many other countries have not been as politically committed to openness and globalization as the Nordic countries have been—and it is here that the interplay of the economic growth and the welfare state has probably played the most important role. Undertaking a process of economic restructuring and specialization is bound to create a lot of uncertainty for many economic agents as well as many losers whose jobs and firms just disappear. With no compensating mechanisms in place, the risk of being a loser as well as the experience of being one would create a lot of opposition towards technological progress and the participation into the international economy. In the Nordic countries, however, the development of a capitalist and internationalized market economy coincided with the introduction of social insurance that mitigated the risks. These processes are described clearly in the Sweden and Finland papers, with both empirical examples and theoretical models. There we have seen a positive spiral: economic development has created the political demand for a welfare state—pensions, unemployment, and sickness insurance in particular—and the creation of welfare services has sustained the political popularity of further economic integration and technological progress.

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