Lessons from the Swedish/Nordic Model

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The Nordic Model

Not easy to make an unambiguous definition

- In the 1990s and 2000s, the Nordic countries have converged to the EU and OECD averages in terms of macroeconomic policies, income distribution, labor legislation, public employment, (average) income taxes and unemployment and sickness compensation

- Other EU countries have similar corporatist labor arrangements and adopted Nordic ALMPs, pension systems, etc

- Significant differences between the Nordic countries in terms of industrial structure, political institutions (EU/EMU membership, education system, etc) and labour relations
General definition of the Nordic model (including Iceland)

- Tax-financed welfare services and social transfers
- Extensive ALMP programs
- High labour force participation rates
- Wage and income equality
- An open economy including an openness for new technologies by cultural and other reasons
Some ambiguous developments in the Nordic countries

One example:

1. Sweden climbed down from the no 1 to the no 10 position in the ranking of equality of disposable income after taxes and transfers (Gini coefficients) in OECD countries 2004-2010

2. Earnings gaps (Gini coefficients) decreased in Sweden 2000-2010
## Real GDP growth in OECD countries (OECD data)

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Positive lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 1

The advantage of flexible exchange rates

See the weakening of the SEK 1993-95, 1996-2001 and 2008-2009

i) The weaker currency made it possible for Sweden (and Finland) to escape the deep recession in the early 1990s

ii) The weaker currency made it possible for Sweden to avoid a deep crisis in manufacturing in 2008-2009
Positive lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 2

The Nordic countries have performed relatively well during the current financial crisis in terms of GDP growth, (net) public debt and public budget balances

But too hasty to make the causal interpretation that the welfare state makes it possible to avoid deep recessions/financial crises

- See Norway, Finland and Sweden in the late 1980s and early 1990s

- See Denmark 2008 –
Positive lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 3

Domestic demand can be kept up in a deep international recession in countries with extensive welfare programs and income equalization but only if housing bubbles and bank crises are avoided

- See the burst of a commercial real-estate bubble and the bank crisis in Sweden and Finland in the early 1990s. The importance of luck: Swedish banks escaped a bank crisis 2008-2009 by the rapid recovery of the Baltic countries.

- See the differences in domestic-demand growth between Denmark (housing bubble) and the other Nordic countries during the financial crisis 2008-2012 (average annual growth):

  DK: -1.1 %   FIN: 0.4 %   NO: 1.5 %   SWE 1.1 %

A nascent financial crisis through the high (and growing) debt/disposable income ratio among households in Sweden (180 %)?
Positive lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 4

The blessing of having a favorable composition of export products and markets

- The teleproduct productivity wonder 1995-2006 and the sector’s large contribution to GDP growth 1995-2000 in Sweden (and Finland)

- The revival of producers of traditional investment goods (except teleproducts) and raw materials goods, especially in Sweden in the 2000s

- The importance of countries other than the EU countries and the US for the Swedish export recovery 2010-2012
Negative lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 1

Fiscal austerity in Sweden in the mid-1990s was not expansionary and thus no good example for the European debt countries today

- The restrictive fiscal policy delayed the Swedish recovery
- The Swedish recovery 1995-2007 was export and technology led (given the weakening of SEK and the favourable industrial structure)
Negative lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 2

Monetary policy since the mid 1990s has had a negative impact on Swedish employment

The return of the Phillips curve!
Figure 1 The trade-off between inflation (vertical axis) and unemployment (horizontal axis), Sweden and the small open Western European countries less Finland on average, 1998-2012. OECD inflation and unemployment data.
Figure 2 The trade-off between inflation (vertical axis) and unemployment (horizontal axis), Sweden and the small open Western European countries less Finland on average, 1998-2012 – HICP data for Sweden
Restrictive Swedish monetary policy

a) Ambitious inflation target 2 % (in practice since 1995)

b) Ambitious fight against inflation given the target

c) Miscalculation of positive productivity shocks (especially in the late 90s)

Consequences:

Swedish has (like Norway) departed more from the inflation target than other OECD countries (see b and c)

Sweden has climbed down the Phillips curve of small open Western European countries (see a, b and c)

Sweden has (like Norway) undershot, not overshot, the inflation target in contrast to other OECD countries with flexible exchange rates (see b and c)
Negative lessons from the Nordic countries (Sweden) in the 1990s and 2000s – Part 3

- Fiscal and monetary rules/targets can be a straitjacket in a deep recession
  - Too cautious fiscal and monetary policy during the current financial crisis in the Nordic countries
  - The Nordic countries with large current-account surpluses (all countries except Finland) should contribute to the European recovery by expansionism
Negative lessons from the Nordic countries (particularly Sweden) in the 1990s and 2000s – Part 4

The financing of the welfare state and the maintenance of small income differentials in Sweden are obstructed by political restrictions on the level and composition of taxes:

1. Baumol’s disease and demography require higher tax rates in the long run

2. Some taxes are less harmful for growth and less vulnerable for globalization than other taxes

“Good” taxes according to economic research:

- Taxes on goods and services
- Property taxes
Revenue of taxes on property (P) and goods and services (G&S) as a percentage of total taxation, 2009

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Source: Revenue Statistics 1965-2010, OECD 2011