

The Global Financial Crisis and the Return of the Nordic Model?

Lars Calmfors

Embassy of Denmark and the Swedish
Institute of International Affairs

18 November

Topics

1. The global economic crisis
2. Globalisation in general
3. The demographic challenges

Unclear terminology

- Nordic model
- Scandinavian model
- Swedish model

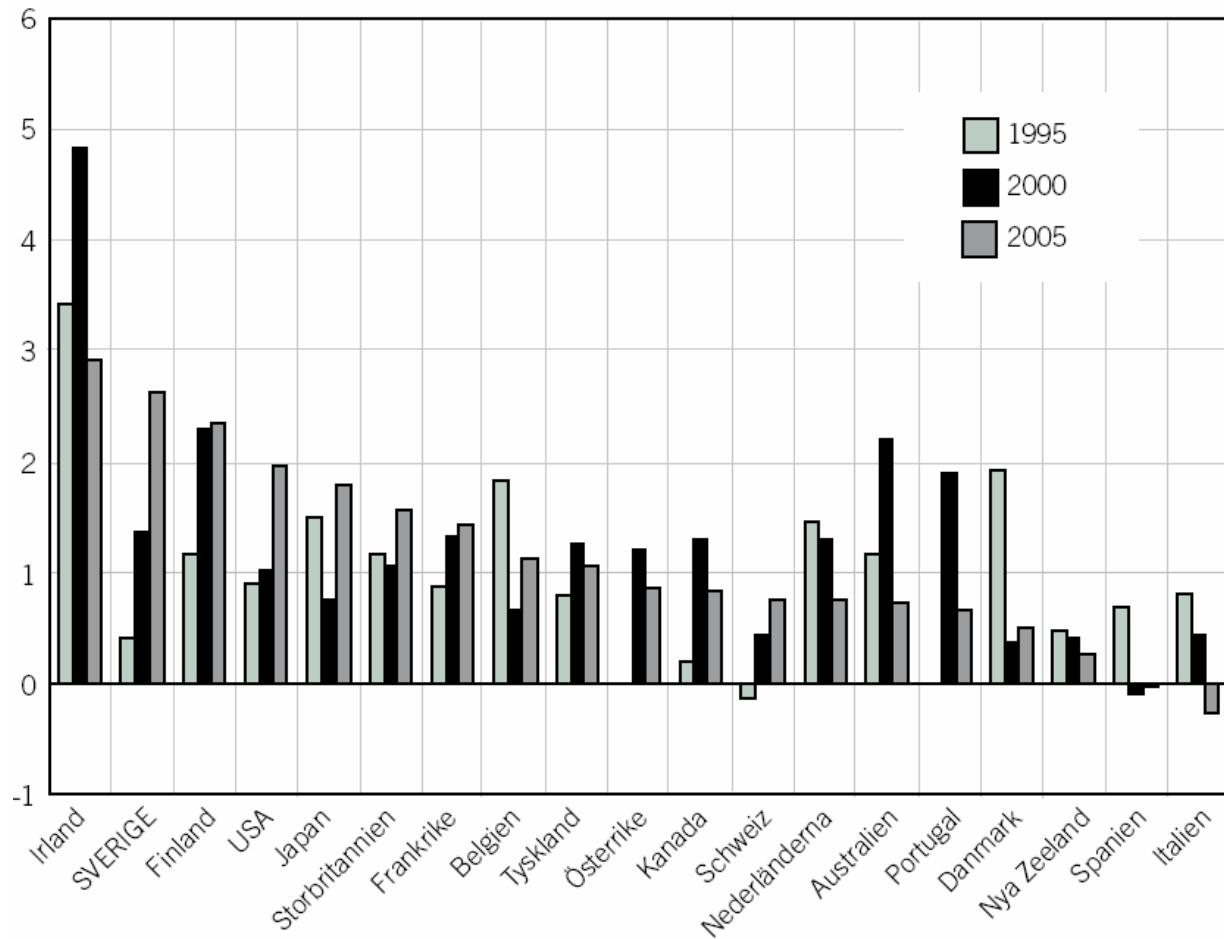
Characterisation of the Swedish/Nordic model

- Macroeconomic outcomes
- Means to achieve these outcomes
- Broad mindsets

The Swedish/Nordic model in terms of macroeconomic outcomes

- High employment
- High growth by Western European standards
- Even income distribution
- Large trade dependence

Total factor productivity, contribution to GDP over five years



Contributions to differences in total employment rates relative to the euro area average from differences in employment rates for various gender and age groups

	Total 15-64	Men 15-64	Women 15-64	Total 15-24	Total 25-54	Total 55-64
Denmark	12.1	4.2	7.8	4.1	4.3	3.7
Finland	4.6	-1.2	5.7	0.3	2.4	1.9
Sweden	10.1	1.7	8.3	1.0	3.5	5.6
Average	9.2	1.6	7.5	1.7	3.5	4.0

The Swedish/Nordic model in terms of systems/institutions

- A generous welfare state with generous social insurance and a large public sector
- High taxes
- Co-ordinated wage bargaining and labour market regulations through collective agreements
- Active labour market policies
- A well-educated work force
- High R&D expenditures
- Deregulated goods markets but more regulated markets for services (including the building sector)
- Fairly little of selective industry support
- A sustainable pension system
- A fiscal framework promoting fiscal discipline

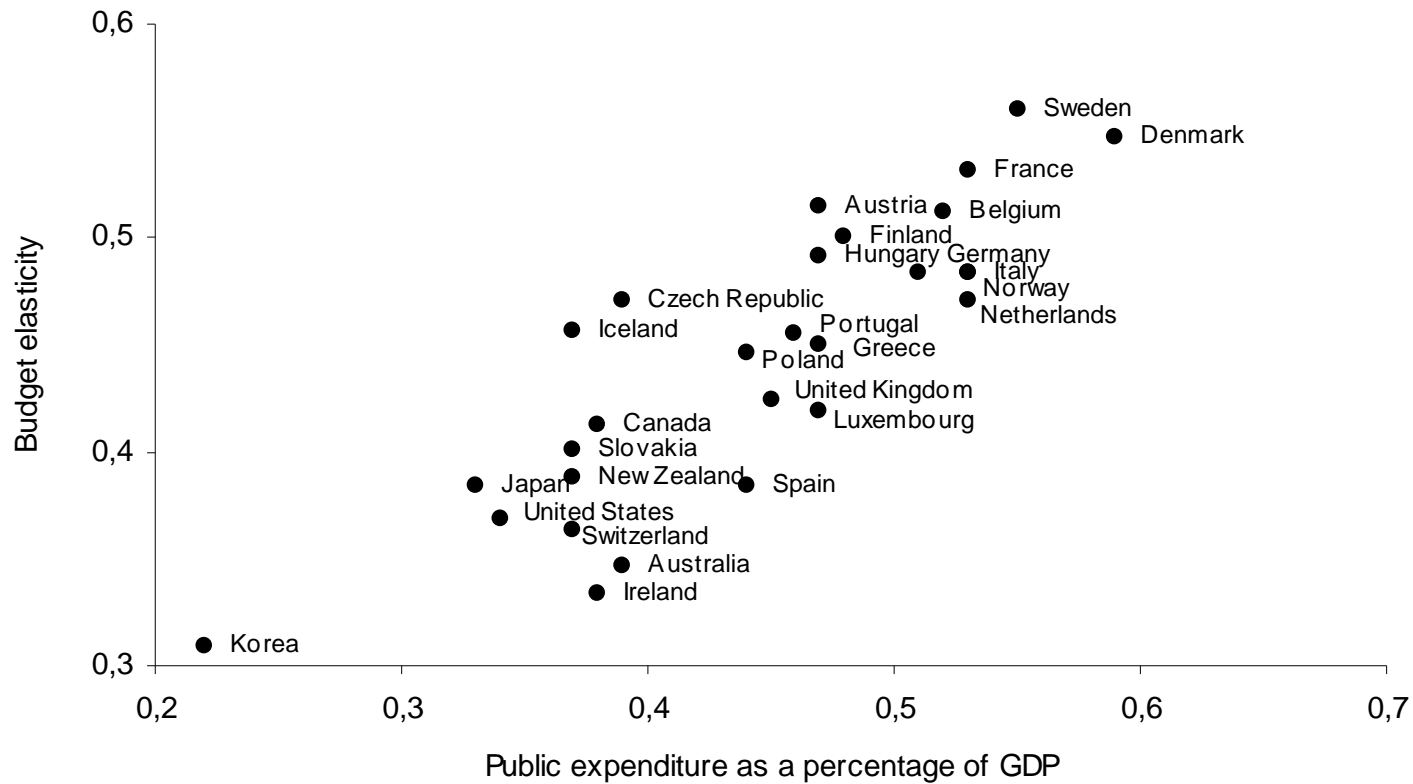
The Swedish/Nordic model in terms of mindsets

- Rational approach to problem-solving?
 - but excessive marginal tax rates in the 1970s and early 1980s
 - tax reform, pension reform, new fiscal framework
- Consensus culture?
 - polarisation regarding unemployment benefits, earned income tax credits, top marginal income tax rates
 - consensus on R&D, product market deregulations, no selective subsidies, trade openness, the pension system, fiscal discipline

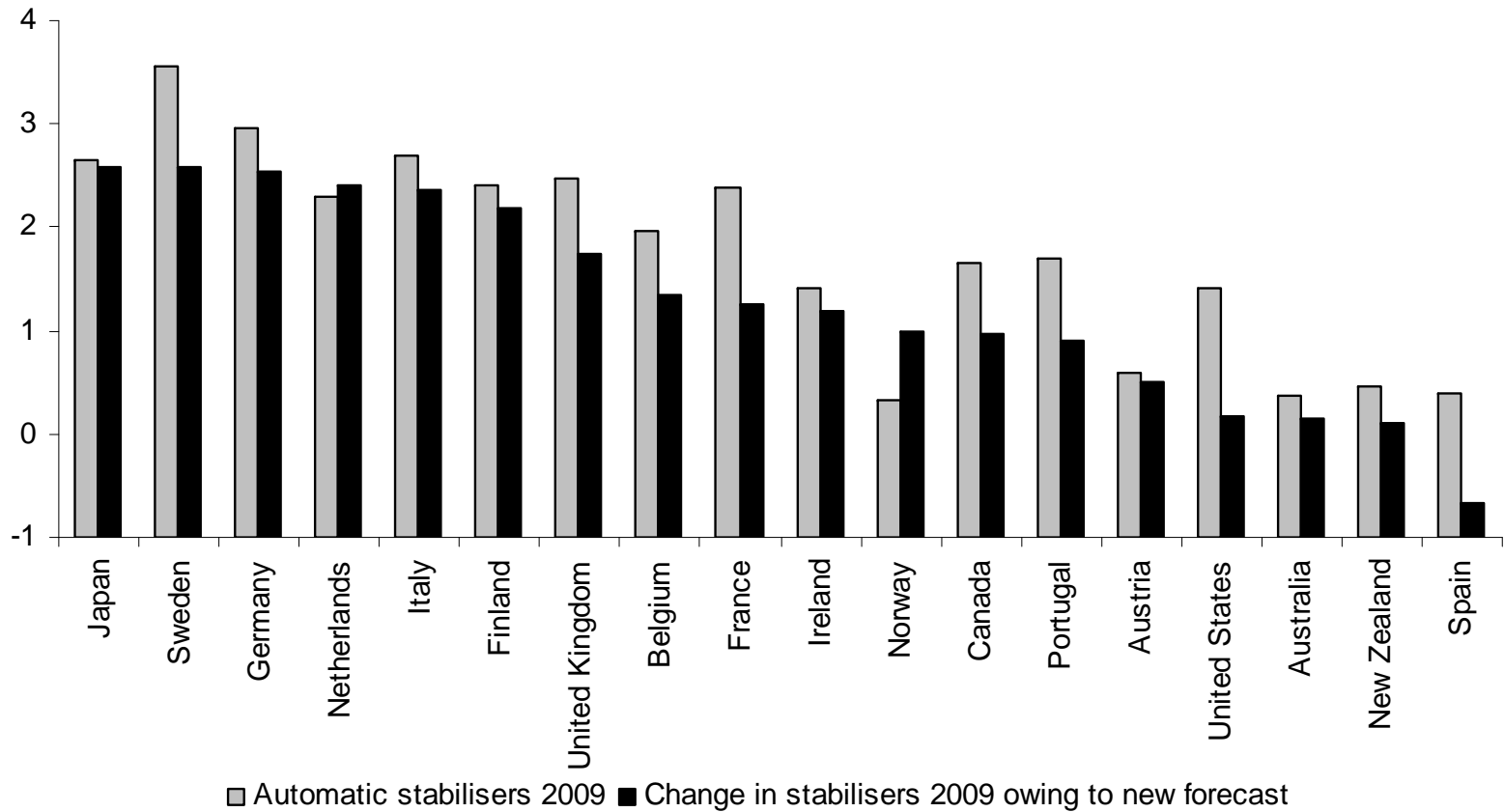
Sweden and the global economic crisis

- Not so much direct consequences of the financial crisis
- Instead consequences of the fall in world demand
 - dependence on exports
 - investment and consumer capital goods
- Big government has meant strong automatic stabilisers
- Strong public finances have given room for expansionary fiscal policy
- The government's labour market reforms
 - less income protection for the unemployed
 - smaller risk that unemployment becomes persistent
 - they may (together with the absence of selective subsidies) have opened up for the work-sharing agreements in manufacturing

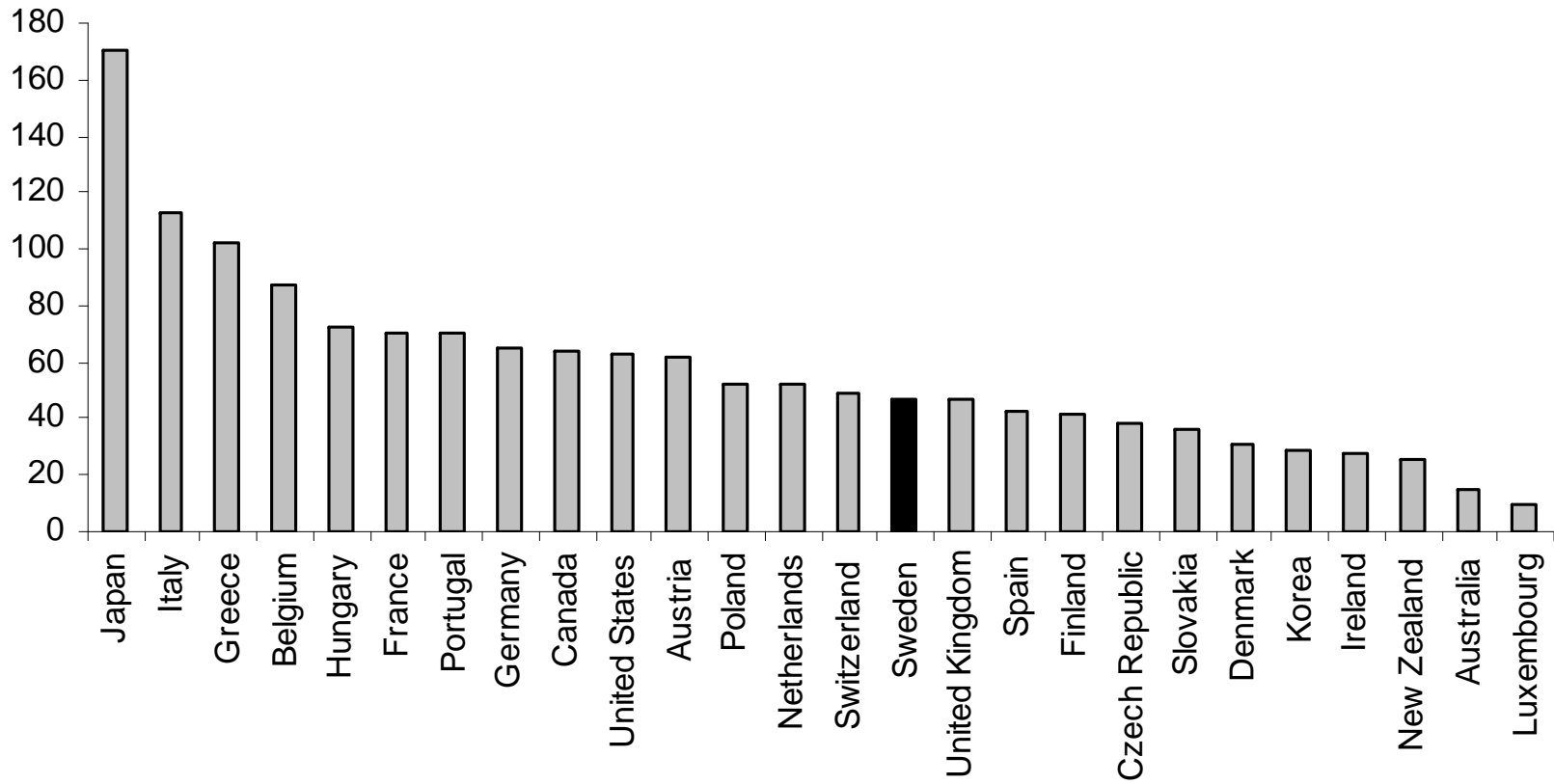
Budget elasticity and the size of the public sector



Automatic stimulus measures



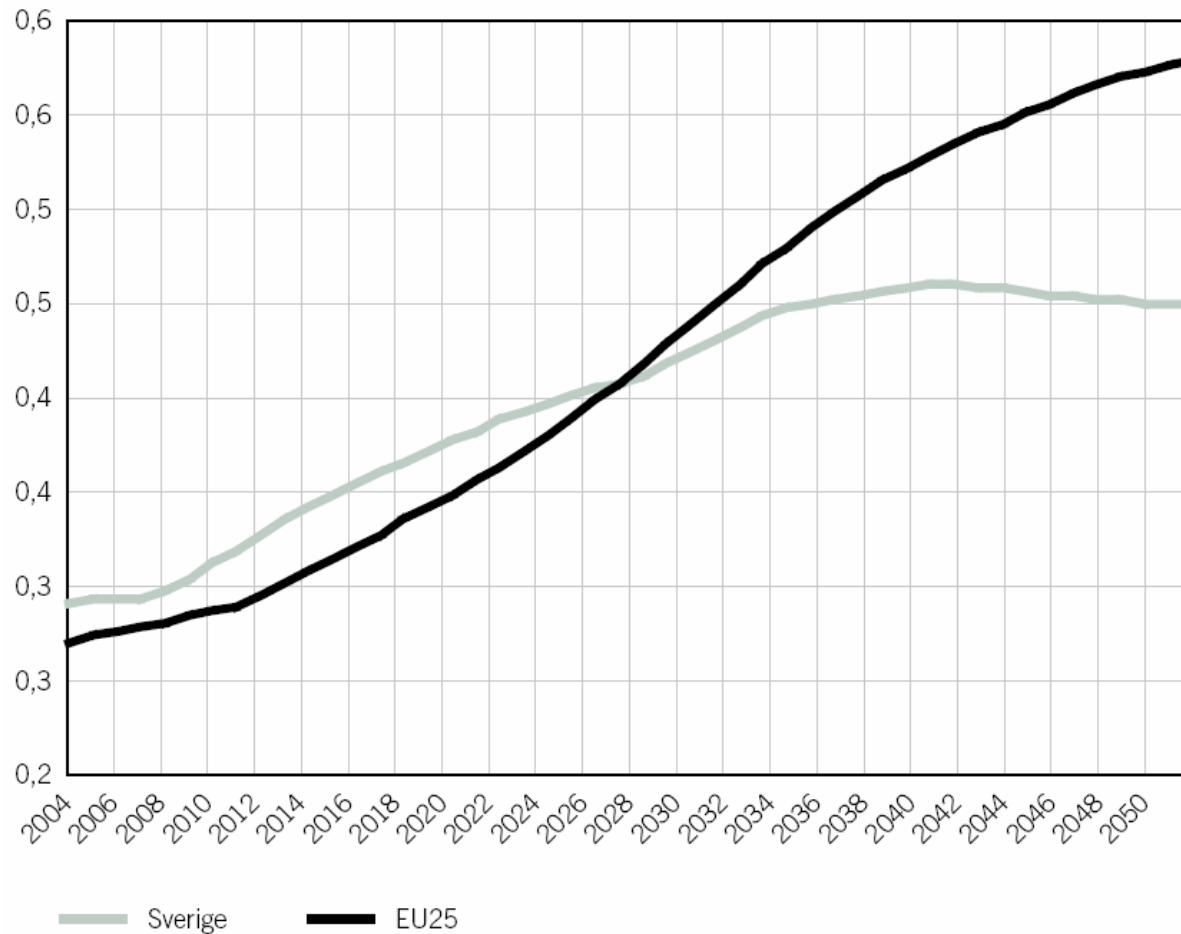
General government gross debt in per cent of GDP



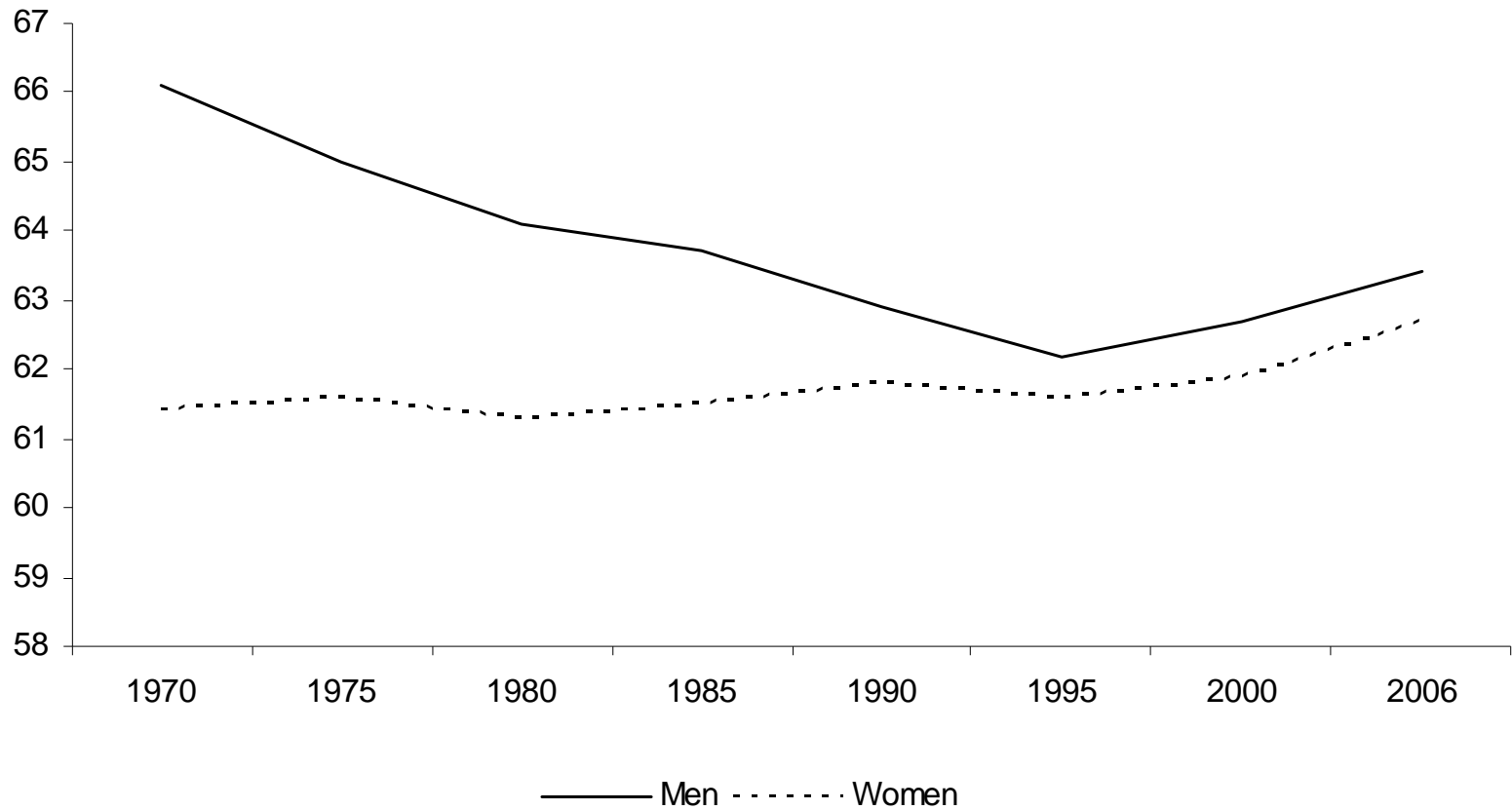
The demographic challenges

- A smaller problem in Sweden than elsewhere but still a formidable problem
- The pension system has been reformed
 - defined contributions instead of defined benefits
- Public finances sustainability calculations are more favourable for Sweden than for other countries
 - but all such calculations are too favourable
 - spontaneous rises of retirement age will not be enough
- Measures to deal with the situation
 - changes in pension rules
 - increased reliance on user fees
 - labour market reforms to increase employment in general
- All measures are politically highly controversial

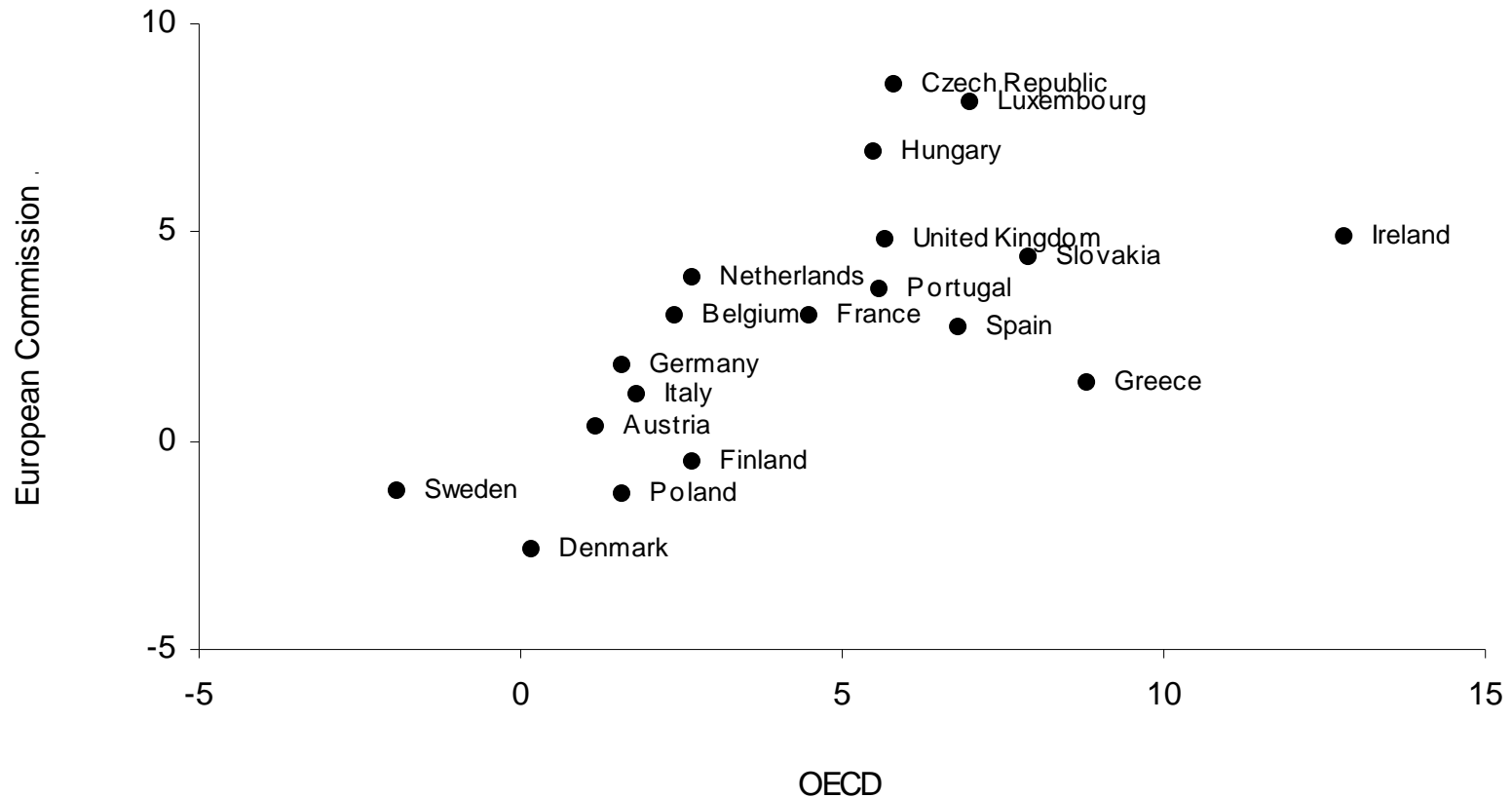
Old-age Dependency Ratio (65+/20–64), Sweden and EU25



Average labour market exit age



Long-term sustainability of public finances (S2 indicator)



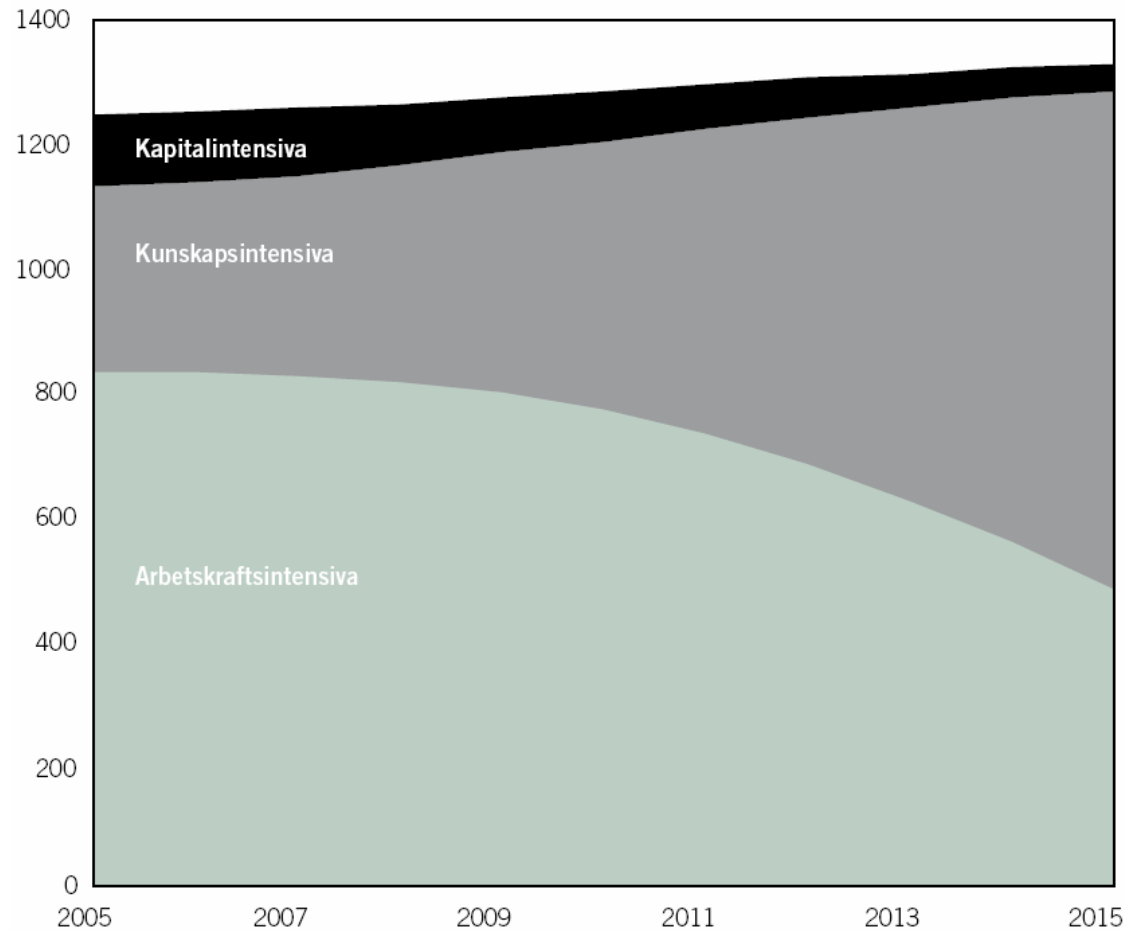
The S2 indicator and intertemporal financial net worth, per cent of GDP

	S2	Intertemporal financial net worth
Base scenario	0.5	-52.5
Higher exit age	-0.8	84.0
Higher health care costs	8.2	-861.0

The challenges from globalisation

- Increase in trade between low-wage and high-wage economies
- Low-wage economies with relative abundance of low-skilled labour should specialise in labour-intensive production
- High-wage economies with relative abundance of high-skilled labour should specialise in skill-intensive production
- Potential aggregate wage gains for all countries

Employment developments (1000s) in sectors exposed to international competition, Sweden



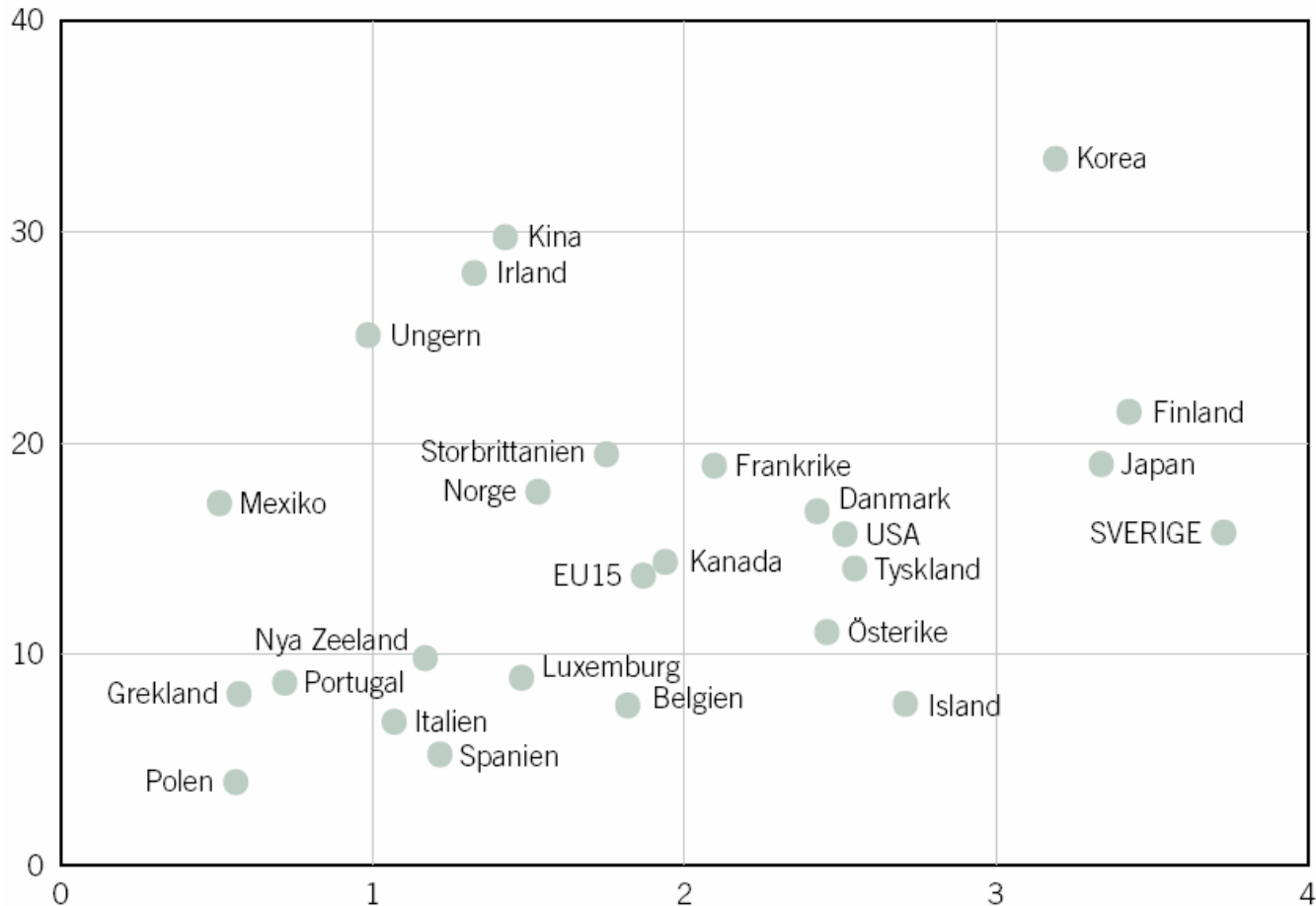
Preconditions for the aggregate welfare gains to be realised

- Sufficient wage flexibility
 - relative wages of unskilled labour must fall
 - otherwise unemployment and too large contraction of labour-intensive sectors
- Trade potential in service sector should be used
 - allow low-wage imports of services
 - near-monopoly of public sector in health care and education is a likely obstacle to successful exports

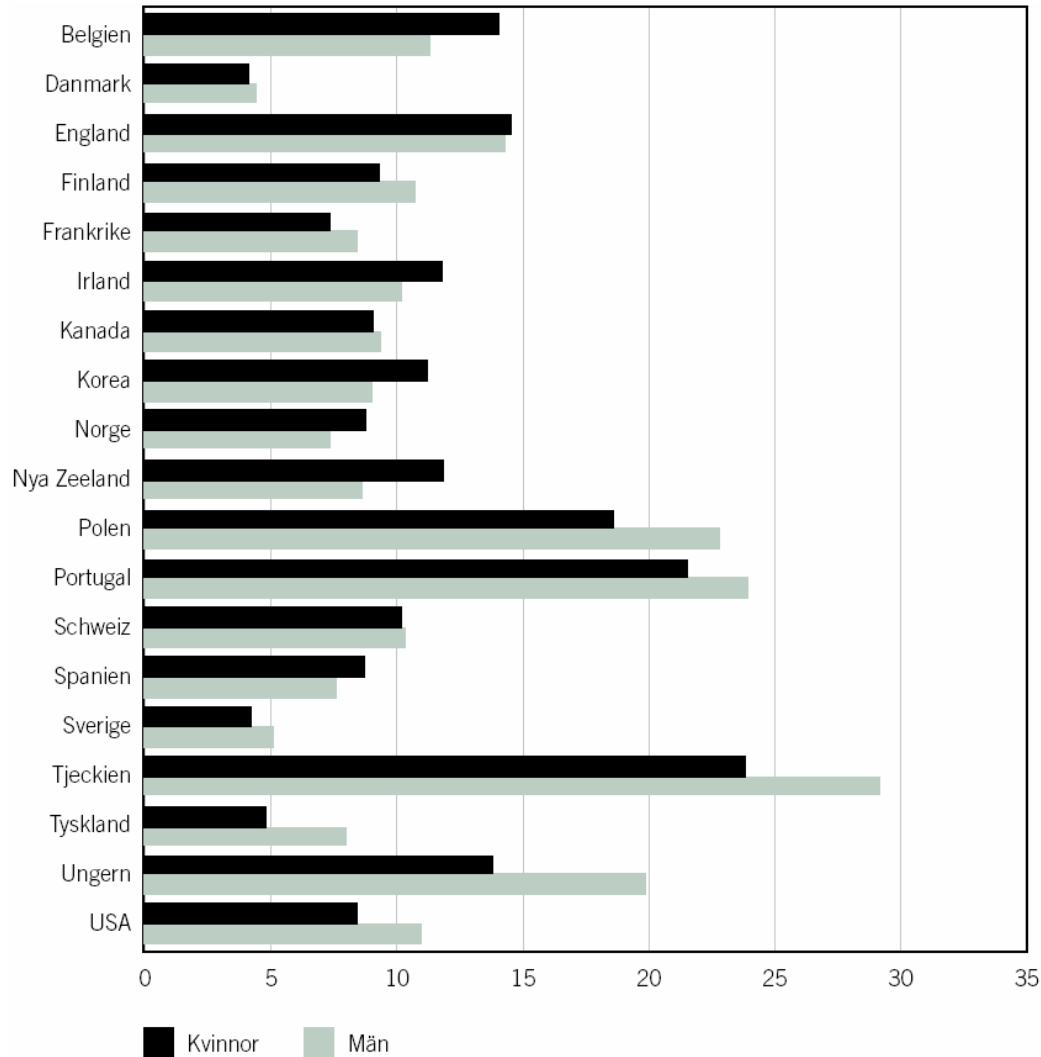
Can we upgrade our production?

- High R&D expenditures but low returns
- Low return to higher education
 - volume of higher education
 - allocation of higher education
- Retraining policies in a state of flux
 - traditional labour-market retraining
 - retraining in the regular education system
 - the role of the parties in the labour market
 - basic youth education

R&D expenditures in percent of GDP and the share of high-technology exports in total exports 2006/07



Returns on higher education 2004, per cent



How well designed is the Swedish model to deal with the challenges?

- Well-designed to cope with the economic crisis
- Better designed than most other models to deal with the demographic challenges
 - but still very large challenges
- Coping with globalisation likely requires large changes in the model
- Key question: Can we reach a consensus on the future equity-efficiency trade-off?