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# 1

## Social Policy and Economic Development in the Nordic Countries: An Introduction

*Olli Kangas and Joakim Palme*

### **‘Constructive destruction’**

The nineteenth and twentieth centuries witnessed major transformations of economic systems around the world. The first was the creation of capitalist markets in the Western hemisphere. The second was the transition from capitalism to socialism in several countries. The third was the transition in the reverse direction: from centrally planned command systems back to market-based economies. The new globalization of business attached to an explosive expansion of information technologies (ITs) and the rapid IT-based industrialization of the Asian economies may constitute a fourth great transformation that will change the economic order of the globe. During such great transformations, there are always winners and losers. In the wake of such changes, old forms of security vanish and new ones take shape. A crucial issue here is how destructive or constructive change actually becomes. In a Schumpeterian sense, we can speak about a ‘constructive destruction’ (Schumpeter 1950). This term refers to a situation where old, inefficient forms of social activities are destroyed and replaced by more efficient and better systems. An interesting question is how and to what extent different countries, or groups of countries, have managed to harness the destruction, in a socially justifiable way, and to create social and economic institutions that can effectively utilize the potentials and possibilities the new situation creates. How can the Nordic experience be interpreted in this perspective?

### **Nature and consequences of the ‘Nordic model’**

Different approaches to the question of social protection have been elaborated among countries with the most advanced industrial market economies. In this context, the Scandinavian or Nordic welfare state model is an established concept world-wide. Yet there appears to be something of a mystery about the nature and consequences of the model. Some scholars have gained their academic credentials by launching the idea of a model

and defining its characteristics, while others have claimed that such a model does not exist at all, that there only are country-specific development paths and outcomes and that instead of the Nordic model we should speak about the Danish, Finnish, Norwegian and Swedish models.

The views concerning the merits and drawbacks of the model also diverge widely among different observers. There are Candide-like opinions that the Nordic welfare state is the best of all possible thinkable worlds, guaranteeing high levels of well-being and decent life-chances to all regardless of circumstances. The most notable achievement in this field is poverty reduction: Nordic poverty rates are among the lowest in the world. For these analysts, the Nordic countries are a good example of how it is possible to unify equality, a 'big' welfare state and a high level of taxation with economic growth. However, critical voices describe the situation quite differently: by equalising incomes through lavish welfare benefits the welfare state creates work disincentives and kills individual initiative, which hampers economic growth. In the longer run, this 'passion for equality' is also detrimental for the poor.

Our opinion is that the extreme views expressed on both sides are often based on wishful thinking or prejudice, on myth rather than reality. This is a challenge for social science research. If we want to take social policy making as seriously a 'learning process', we need to base our evaluation of different social policy strategies on facts and systematic analysis, not on assumptions. Comparative studies can make a contribution by contrasting different solutions, their advantages and their problems. The purpose of this volume is to discuss these and other issues related to Nordic social policy and development from a historical and comparative perspective.

The aim here is not to dig too deeply into the debate about the 'true nature' of the Scandinavian welfare state, our approach is more pragmatic. We think that there are important commonalities as well as essential differences between the Nordic countries that all deserve to be described. Given the long common and tightly interwoven history of these countries, any other state of affairs would perhaps be surprising. Without denying national variations and differences between the countries, for practical reasons and space considerations we emphasize here commonalities more than country-specific characteristics. This is also a question of perspective: The wider the perspective, the more homogeneous the Nordic<sup>1</sup> hemisphere appears to be, while a closer focus would generate a more heterogeneous picture.

In a developmental perspective (Mkandawire 2001), we argue that there are at least three important things to be learned from the Nordic model. First, while democratization can bring pressures for expanded social policy, social policy can also contribute to democratization. In this respect, the Nordic countries, with their universal and all-encompassing social policies, may serve as good examples. Indeed, the link between social policy and democratization has historically been very close in Scandinavia. Secondly, the clearest achievement of the Scandinavian welfare state has been in poverty reduction

programmes and there are also lessons to be learned from performance here. The third aspect relates to the role ascribed to the state. Some neo-liberal thinkers suggest that the state should retreat from social provision and leave a more active role to non-governmental organizations (NGOs); only in that way can countries safeguard economic growth. However, the Scandinavian countries display a high level of prosperity and rapid economic growth despite their high social spending. In this respect, the Nordic countries thus demonstrate that it is possible to unify social protection with competitive and growth oriented economies.

Yet the relationship between the welfare state and efficiency is poorly theorized and little studied, both theoretically and empirically. Several factors have contributed to this. One is that intentions have been confused with actual outcomes. Another is that the architects behind the systems may have feared a critical examination of the outcomes (Sørensen 1998). There has also been an unfortunate starting point in some of the neo-classical analyses that all forms of taxation must mean efficiency loss, and instead of comparing different kinds of intervention the actual interventions are contrasted with a no-intervention situation: being Hell is compared to blessings of Heaven. A more realistic approach would be to examine different kinds of interventions by utilising comparative research more extensively.

### **The model's historical legacy**

In order to be able to understand the present situation, it would appear useful to identify the basic elements of the model's historical legacy and ask four key questions:

- What are the basic elements of the model?
- What have been the driving forces behind its development?
- What have been its achievements?
- What have been the negative unintended consequences?

This may then help us to address two more questions:

- What are the problems and dilemmas facing the model?
- Can we identify any solutions to these dilemmas?

We would argue that the historical lesson here is that reforms of social policy programmes are responses to changing economic and social structures as well as to political mobilization. The fact that structural changes have been important for social policy reform implies neither that values have been unimportant for shaping the institutions, nor that decisions have come about without political action. Once established, institutions create interests, but also become bearers of values and expectations, and thus create their own *path dependency*; the essence of these institutions can either enhance or inhibit reforms.

## **Themes of the volume**

This volume includes a number of special studies organized around four different themes, which have been given the following broad headings:

- The history of the model
- The consequences of policy design
- Economic and social policy
- The information society and challenges to social policy.

### **The history of the model**

Chapter 2, by Kangas and Palme, 'Coming Late – Catching Up: The Formation of a 'Nordic Model'', provides both a historical account of the the Nordic experience and a conceptual framework for the entire book. Most of the issues that are taken up in Chapter 2 are analysed and discussed in more detail in the chapters that follow. The first outlines the broad historical commonalities in the social, economic and political structures of the Nordic nations, while also recognising the evident differences. The emergence of modern social policy legislation is also traced back in history. Four sections on different policy areas or programmes follow. The emergence and formation of old-age pension are followed during the course of the twentieth century. A section on sickness insurance (i.e sickness cash benefits) follows. There is a section on the particularities of unemployment insurance before the coverage and adequacy of various benefits among the Nordic countries are compared to those in the other advanced industrial nations. Coverage is clearly higher than in other countries, adequacy is high but not outstanding. The focus is then moved to what, in broad terms, can be labelled 'family support'. The social services sector, including education, is described and the cash benefits analysed. There is a clear Nordic exceptionalism when it comes to the social services. Four sections analyse various aspects of poverty and inequality from a social policy perspective, the reduction of poverty and inequality turns out to be substantial among the Nordic countries. The effects of different policy designs are also discussed in a section on labour supply. Here, the effects appear to go in different directions: labour force participation is high among the Nordic countries whereas the number of hours worked per employee is modest. Social trust is analysed in a social perspective in the next section. The chapter concludes with a section on the economic crisis of the 1990s, which struck Finland and Sweden particularly hard. Here, both policy changes and the consequences of welfare cuts are given attention, as well as the strategic choices made in the two countries regarding social policy design.

The focus in Eero Carroll's Chapter 3, 'Voluntary State-Subsidized Social Insurance in the Advanced Industrialized World since the 1890s: The Nordic Experience in Comparative Perspective' is on the institutional emergence and 'mortality' of voluntary social insurance in the highly industrialized

North. According to Carroll, one major site of welfare cooperation between states and social movements in the industrialized North has been voluntary state-subsidized social insurance institutions, particularly for the sick and for the unemployed. When they emerged, in the latter decades of the nineteenth century and extending into the 1930s, many such programmes were no less untried than what contemporary state – NGO cooperation ventures have been in facilitating Southern social development. Carroll argues that the question of whether this Northern experience can also inform development strategy discussions in the South is linked to the larger questions of whether socioeconomic development paths are multiple, and of whether Southern countries can usefully follow or learn from Northern precedents.

According to Carroll, the voluntarist model is interesting in how the state uses NGOs to develop institutions which the state lacks capacity or will to develop itself. In current development debates, state disengagement from social provision is advocated to cut costs and enable states to concentrate on 'core activities'. Given possible countervailing disadvantages, Carroll emphasizes the diversity of policy considerations about 'third-sector' provision that should be borne in mind from European historical experience when considering such policies elsewhere today.

When discussing the costs and benefits of voluntarism, Carroll emphasizes that state-subsidized voluntarism may be motivated if certain conditions are met. State-subsidized sickness and unemployment insurance funds have historically constituted vital 'schools of democracy' in the Nordic countries, not least for working-class constituencies traditionally under-represented in voluntary organizations. Especially if embedded in a broader network of corporatist institutions, voluntary subsidized insurance institutions may constitute sites where 'bridging social capital' can be generated. Participation of union officials in administering state-sanctioned social welfare may bind civil society and the state more closely together – in ways that facilitate not only union membership but also social development, and the greater overlap of special and general interests.

However, Carroll warns that such benefits by no means automatically follow from voluntarism. Policy makers should particularly be warned against the idea that voluntarism can constitute an easy 'stepping stone' to compulsory insurance later, as well as against exaggerated visions of budgetary savings. Differences in costs may end up being minimal if state subsidies keep expanding in order to reach broader inclusion.

Carroll's general conclusion is that the complicated interplay of public, civil and private organizations runs throughout the social landscapes of both the global North and the global South. Criticism against 'one-size-fits-all' recommendations to developing countries, and of the unconditionally voluntarism-friendly Third Way variety, may be the only 'best practice'. If combined at all, state and voluntary provision should aim for *complementarity*, with clear jurisdictions and uniting the best of both methods.

### The consequences of policy design

The starting point in Anneli Anttonen's Chapter 4, 'Empowering Social Policy: The Role of Social Care Services in Modern Welfare States', is that while anchored to its national and normative contexts, care is exposed to many pressures when societies are changing. According to Anttonen, this is not a matter of ideological change taking place in the economy and politics, change that generally arises from structural adaptations to economic competition. Some ideological shifts appear to be relatively isolated from changes in the economy and patterns of employment – for example, moral debates about family responsibilities. Others are more clearly rooted in changes in everyday life – such as the discrepancies between social policy assumptions and the growing participation of women in paid employment. Although the forces of change are, to some extent, pushing in the same direction, they have not yet produced much cross-national uniformity in care policies. Unlike social security systems, care arrangements remain distinctly national and local innovations are common.

However, care is changing as both an informal and a formal activity, and quite rapidly. Most importantly, care is leaving the intimate sphere of family and kinship: it is going public everywhere. One consequence of the change in the locus of care from the family to other sectors is that it becomes *monetized*: it has to be paid for and its costs are revealed. This form of 'going public' may happen independently of social policy decisions, simply because more households need or choose to buy care services. Another side of the coin is that governments may create a public policy of care so that care becomes a social good and social right of citizens. Some governments have been much more active in the process of care 'going public' than others. The Nordic democracies have been active in favouring women-friendly solutions in care and family policies; internationally generous social care provision has promoted gender equality in terms of women's labour market participation.

The Scandinavian experience demonstrates that social solidarity and individual autonomy can be enhanced through legislation and the idea of universal social citizenship may be realized. It has meant that marginalized and other oppressed groups, such as women, have become a part of the social policy contract. It has been extremely important for women to extend social rights to cover such things as the caring of young children and the elderly, sick and disabled members of society. In Scandinavia, women have been more successful than elsewhere in combining their dual role as mothers and workers, and social policy arrangements have been an integral part of gender equality policy.

Anttonen sums up by pinpointing the fact that women's changing role as mothers, carers and workers has brought into being a society in which care relations have to be reorganized and renegotiated. A public policy of care is thus becoming a more and more important part of welfare states. When we talk about 'caring', we are talking about shifting boundaries between private

and public responsibilities: caring is also sharing in the sense that there are now more social actors producing care and care services.

The focus in Tommy Ferrarini's and Katja Forssén's Chapter 5, 'Family Policy and Cross-National Patterns of Poverty', shifts to the cash side of public support to families. Historically, children have been the most vulnerable group exposed to poverty. Anti-poverty measures directed towards children and their families have always been constrained by tensions between the interests of the state and the rights and responsibilities of the parent. Poverty in families with children may have severe consequences for the individuals living under such circumstances not only in the short run, but also in the longer perspective. The shortage of external resources is reflected either directly or indirectly in the well-being of the child, which in a longer run may have detrimental consequences for the child's future development. These statements form the general starting point for Ferrarini's and Forssén's chapter.

The authors distinguish three different family policy regimes according to two separate dimensions, depending on whether they support a *traditional* family (general family support), where the father is the main earner and the mother mainly is expected to see to care work, or whether they support a *dual-earner* family (dual-earner support). The third variant is the so-called 'market oriented' model. According to Ferrarini and Forssén the main motive behind family policy programmes in the Nordic countries has in recent decades been to support the dual-earner family, while Continental European countries have primarily maintained family policies in support of traditional family patterns, with a main male earner and a female home-maker. Family policies in the English-speaking countries are market oriented, and support for both the traditional and the dual-earner family has consequently been less developed, leaving larger room for means-tested benefits with a more direct ambition of alleviating poverty.

The comparisons presented indicate that support for the dual-earner family policy is most effective at reducing poverty among all families with children. Welfare states with the lowest universal and earnings-related benefits, as well as low utilization rates of public child care, and thus heavily reliant on means-tested benefits in the provision of economic resources to poor families, also have the highest poverty levels. Countries with the most generous earnings-related parental leave benefits and high utilization of public child care also have the lowest poverty levels among families with children. Thus the answer to the main question the authors pose – whether family policy is related to cross-national patterns of poverty for families with children – is unanimously 'yes'. The analyses carried out suggest a strong link between social policy institutions and distributive outcomes. In particular, dual-earner models of family policy, such as those developed in the Nordic welfare states, seem effective in reducing poverty. Such welfare states are probably particularly effective at reducing poverty because family policy

programmes provide both adequate benefits to families with children, that are often earnings-related and universal, and because transfers and services also provide incentives for female labour force participation as well as for male participation in care work. Furthermore, according to Ferrarini and Forssén, welfare states with family policy models that largely support traditional family patterns generally have medium levels of poverty among families with children. Countries with market oriented family policies, largely reliant on targeted benefits and services to the poorest families, have the highest poverty levels, contrary to what proponents of selective measures would predict.

In Chapter 6, 'Education and Equal Life-Chances: Investing in Children', Gøsta Esping-Andersen examines two factors that underpin the study of educational systems. First, knowledge-intensive economies push up skills premiums and when the returns from education are rising the less skilled are in danger of falling behind in the earnings distribution. According to Esping-Andersen, youth with poor cognitive skills or inadequate schooling today will become tomorrow's marginalized workers, likely to face a life-time of low wages, poor-quality jobs and frequent spells of unemployment or assistance dependency. The second feature has to do with the relatively large share of low-qualified jobs that coexist with service economy growth. This would appear to negate the argument that low-skilled workers are at risk were it not for the strong likelihood that such jobs will become dead-end, low-paid career traps. Current policy fashion advocates activation, retraining, and life-long learning as a way to combat such entrapment, but these programmes are ineffective unless participants already have strong cognitive and motivational abilities. Mobility is a realistic possibility only for those who already possess skills from youth.

Esping-Andersen points out that the advanced economies face a rising skill problem as far as individuals' life-chances are concerned. Yet, from the point of view of the collective good, the problem is the same. The advanced economies must rely almost exclusively on their human capital to gain a competitive edge in the world economy. Our societies are ageing very rapidly and future working-age cohorts are bound to be very small. Sustaining the welfare of a large aged population necessitates a highly productive labour force. In the new economy, countries can no longer afford social inheritance. What can we do?

Esping-Andersen offers two answers and policy options. First, the design of *school systems* can make a difference. Few would doubt that early tracking or segmentation based on ethnicity, race or social class help reinforce stratification. The important conclusion, however, is that equal opportunities will not come about solely through education policy. Secondly, we must rethink the link between *education and social policies*. This is clear when we recognize the potentially very negative effects of economic hardship on educational attainment and subsequent life-chances. One lesson from the Nordic welfare

states is that the eradication of child poverty can yield very positive results, not only in terms of alleviating material hardship in childhood but also because economic security is a vital precondition for later achievement. Thirdly, according to Esping-Andersen, 'money' is a necessary but not a sufficient precondition for good life-chances. The data he presents show that cognitive inequalities are substantially lower in Scandinavia, and the trend towards declining social inheritance coincides almost perfectly with the era of building up universal day care, indicating that that life-long learning must begin at age one.

Esping-Andersen concludes up by arguing that if our sole concern is to fulfil the 'caring vacuum', the USA has shown that fairly broad access *can* be achieved through the market system. If we aim to build part of our equal opportunities policy into child care provision, however, then clearly an American-style approach will fail and perhaps something can be learned from the Nordic experience.

Health is one of the most important elements in an individual's welfare, as all level-of-living surveys done in the Nordic countries indicate. In their Chapter 7, 'Fighting Inequalities in Health and Income: One Important Road to Welfare and Development', Johan Fritzell and Olle Lundberg introduce some basic elements in the Swedish/Nordic welfare survey tradition and discuss the Nordic approach to research on welfare and its relation to various forms of social and other policies. Their analysis focuses on income and health as important factors for welfare, development and inclusion. The Nordic countries are well known for their low poverty rates and modest income differentials. Internationally speaking, the overall performance in terms of general health objectives appears to be good among the Nordic countries: low infant mortality and long life expectancy are two examples. Inequalities in health also persist in Nordic countries, however Fritzell and Lundberg give data on health differences by social status in selected countries. They emphasize that the consequences of income inequality for health have been recognized in comparative research but that the mechanisms have been far from fully explored. One major task in their chapters is to fill this gap. Drawing on Swedish as well as comparative research, their study helps to improve our understanding of the links between health, inequality and growth, and how policies as well as inequalities can affect these relationships

Fritzell and Lundberg have four principal findings. First, welfare is a *multidimensional* concept and so welfare measurement should:

- Study the prevalence of inferior conditions rather than those where people are faring well economically
- Use descriptive rather than subjective indicators
- Study how welfare areas are inter-related.

They find that health and income are two key components of level of living. Secondly, comparative analyses have shown that the Nordic countries

have small income differentials and low poverty rates compared with other rich nations. These outcomes are closely related to a relatively *universal social insurance system*, but also to *high employment rates*. Thirdly, *relative health inequalities* are not consistently lower in the Nordic countries in comparison with other European countries. However, this is partly, in the Swedish case at least, dependent on a very good health status among the upper social strata of the population. In the Finnish case, research evidence suggests that the relatively unfavourable statistics are mostly due to historical conditions and consequently seen only among the elderly. In infant and child mortality rates, all the Nordic countries perform extremely well. Finally, the association between income and health is *curvilinear*. In other words, for both individuals and for nations we find diminishing marginal health returns of income. This implies that reducing income inequalities can lead to improvements in population health status.

Fritzell and Lundberg emphasize that health cannot be 'redistributed' in the same manner as income. Structural forces leading to class differentials in health are not easily eradicated, and fully understanding these is of great interest from a purely scientific view point. It may be that from a public policy point of view, however, it is more of interest to focus on the health status of vulnerable groups when making a comparative evaluation. Seen in that perspective, the Nordic countries also perform comparatively well, which is likely to foster economic and social growth and development. Fritzell and Lundberg argue finally that what really matters is to improve living conditions and lessen inequalities in conditions. In other words, they suggest that it is the Nordic social policy model at large that is of the greatest importance in understanding the health status of the population.

### **Economic and social policy**

The starting point in Walter Korpi's Chapter 8, 'Does the Welfare State Harm Economic Growth? Sweden as a Strategic Test Case', is a critical discussion of the previous analyses on the relationships between economic growth and social policy. Korpi's case study is Sweden, as displayed in economists' analyses. Neo-classical economics predicts that taxes and other political measures associated with welfare states generate distortions in the functioning of markets. Sweden, as perhaps the most developed welfare state, has constantly been used to illustrate this argument: because of 'Swedosclerosis' the Swedish economy is lagging behind other comparable economies. According to Korpi, the empirical work here reveals more efforts to find figures illustrating theoretically assumed outcomes than studies testing hypotheses concerning possible outcomes.

Korpi focuses on the often-overlooked problems of *reliability* in the empirical data used in analyses of comparative growth rates. Data reliability can generate problems especially in the middle-range countries where Sweden and the other Nordic areas are often clustered. Because of the clustering of

countries, small and relatively unimportant differences among them affect rankings. Recognizing this problem, Korpi pinpoints the fact that measures of GDP levels adjusted to purchasing power parities (PPPs) are unreliable and should not be used in detailed country rankings and should be used only for broad groupings of countries. Sweden would then come in the same category as Australia, Belgium, Canada, Finland, France, Germany, Ireland, Italy, Japan, The Netherlands, and the UK. The conclusion is thus that Sweden is not doing as badly as argued in economists' analysis.

From a neo-classical theoretical perspective, strong predictions have been derived to the effect that with increasing taxation and welfare state expansion labour supply as well as growth rates will suffer. Korpi demonstrates that empirical studies on the sensitivity of labour supply to taxation have shown only rather limited negative effects, although somewhat more for women than for men. He demonstrates that in analyses of comparative growth rates, data are much more shaky, and that it has proved difficult to establish evidence for major negative growth effects, including for Sweden, where such negative effects would appear to be most likely to emerge. The efforts to prove major negative effects of welfare states on labour supply and growth have not so far been very successful.

Korpi demands more evidence-based policy recommendations. According to him, it is necessary to have empirical verification of the bases upon which policy advices are founded. From a policy-related perspective, what is needed is studies of the instances where hypotheses on negative effects of taxes and welfare programmes can be empirically analysed. Such studies should focus on the microlevel as well as on the macrolevel. Korpi's policy advice is that it is also necessary to analyse consequences of welfare states that can be seen as positive, and to attempt to consider how to balance potentially positive and negative aspects.

Walter Korpi's chapter covers a period up to the early 1990s. Chapter 9, by Jaakko Kiander, 'Growth and Employment in "Nordic Welfare States" in the 1990s: Crisis and Revival', takes a close look at the 1990s alone. Kiander's contribution indicates that after the deep recessions of the early 1990s, all Nordic countries experienced a strong recovery. On average, post-recession Nordic growth rates of output, employment and productivity are almost the same as in the USA in the same period, and much better than the EU average. Within the Nordic group, output growth has been fastest in Finland and Iceland, and employment growth about 2 per cent per annum in Finland, Iceland and Norway. The highest productivity growth has been achieved in Finland and Denmark. According to Kiander, the good economic record of the latter half of the 1990s may indicate, that the Nordic economies still are functioning well, notwithstanding the earlier crises.

Kiander asks what role of economic integration had in explaining the good performance of the Nordic countries, and he highlights two answers. First there are several commonalities in the Nordic economies: they are all

subject to the single market regulations of the European Union, for example. Nordic countries have also been ahead of European deregulation by being the first to liberalize telecoms and electricity markets under deliberate state policies. Secondly, a central part of the Nordic integration processes in the 1980s and 1990s involved changing monetary regimes. In the 1980s, all the Nordic countries fixed exchange rate targets, attempting to imitate the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS), although they were formally outside of it. After the currency crises of 1992 the paths of the Nordic countries started to diverge. Finland's goal was to join EMU. Denmark decided for political and clearly non-economic reasons to stay formally outside the monetary union but still have a fixed exchange rate *vis-à-vis* the euro. Sweden, Norway and Iceland remained in a floating exchange rate regime with explicit inflation targets. In spite of their different choices, all the Nordic countries adopted a policy of low inflation and central bank independence. The adjustment process to a new regime of stable prices was initially painful for them all, although the new regime has proven to function well in the long run.

Kiander concludes that the Nordic welfare model survived the test of the 1990s. The model faced a real crisis when public deficits and unemployment rose to record levels in the mid-1990s due to world-wide recession. However, instead of being locked into an 'unemployment trap' the Nordic countries recovered quickly after 1995 and enjoyed similar and sometimes even better growth rates of output, productivity and employment than the US economy. Between 1995 and 2000, all the Nordic countries successfully reduced open unemployment significantly and turned public finances from deficit to surplus, while maintaining their welfare states. The adjustment was made by raising taxes and restricting the growth of public expenditures, but not by changing the basic structure of the national welfare model. The Nordic countries can still thus be regarded as advanced welfare states with high public employment, universal benefit systems, extensive publicly provided welfare services, high taxes, low poverty and corporatist labour market structures.

However, Kiander also highlights some possible problems. In the future, extensive welfare systems, although they seem at present to be functioning well, are likely to face further challenges from integration, globalization and demographic change. Further integration of European economies may increase pressure for tax competition, which could threaten the financial basis of the welfare state. The Nordic countries have already responded to tax competition by lowering corporate tax rates and taxes on capital income. These changes have been compensated by other tax increases and labour incomes and private consumption are now heavily taxed. It is not clear how sustainable such a regime of high taxes will be in the future if mobility of goods and employees increases. If further pressure to lower taxation emerges, the financing of the increasing public pension and health care expenditures

of an ageing population may be difficult – possibly more difficult for the Nordic countries than for other European countries, because the initial level of taxation is so high and there is less scope to increase labour supply because of already high labour force participation rates. Some leeway for the Nordic governments may, however, be provided by their exceptionally good fiscal positions.

Ola Sjöberg's Chapter 10 is entitled, 'Financing "Big-Tax" Welfare States: Sweden during Crisis and Recovery'. Sustainability of taxation is, of course, a critical question since most countries are facing a number of important challenges to the financing of their social protection systems. Changing demographic structures mean that a larger portion of the population will have to be supported by a shrinking one. Many predict that the globalization and internationalization of the world economy will also put important constraints on the financing of social protection, in terms of both what overall level of taxation is feasible as well as the rate at which different tax bases can be levied. Sweden can in this context be considered as something of a crucial 'test case' concerning the financial viability of large welfare states. Social expenditures and the total tax burden in Sweden are among the highest in the world, and in the 1990s Sweden experienced a severe economic recession which put heavy pressure on the public finances.

With this as a background, Sjöberg describes the financing of the Swedish welfare state from a historical and comparative perspective. The first part is devoted to a description and analysis of how social security programmes have been financed in Sweden against the background of developments in the OECD area. The focus then shifts to the financing of local government activities in the welfare arena. Given the importance of taxes on wages and income from work for the financing of almost all levels of the Swedish welfare state, Sjöberg concludes with a discussion and analysis of taxation and labour supply.

Sjöberg draws three main conclusions from his analysis. First, Sweden (like most other industrialized countries) is, and will in the foreseeable future continue to be, highly dependent on *taxation on labour* for financing the welfare state. The question of how to put as many people as possible to work is thus of vital importance. It is of crucial importance to recognize the complex relationship between the financing of the welfare state and other areas of welfare provision. Secondly, the way in which social protection is financed is not only, and perhaps not even primarily, a question of *economics*. Sjöberg demonstrates that the question of how to divide the costs of social protection in society can have important, and sometimes decisive, importance for how social policy reform is viewed by the public and for the legitimacy of social policy institutions. Thirdly, the way in which social security programmes are financed is to an important extent dependent upon which *institutional social policy model* is being applied. The financing structures of today may constitute an important foundation for the possibilities of future reform.

### The ‘information society’ and challenges to social policy

The central issue in Pekka Himanen’s Chapter 11, ‘The “Nordic Model” of the “Information Society”: The Finnish Case’, is about the political choices available in the ‘information age’. He addresses the following question:

- Does the rise of the information age necessarily increase social inequality and exclusion, as seems to be the dominant trend in the world?

In many political circles, it is believed that the answer is ‘yes’. Many countries have thus chosen the route of competing in the global world by cutting back the welfare state. However, Himanen emphasizes that if we look at empirical data on which countries have succeeded as ‘information societies’, the picture is much more complicated. The Nordic welfare states have for many years topped the International Data Corporation (IDC) Information Society Index, which reflects the adoption of new information technology (IT) – such as computers, internet and telecoms – in society. According to the UN Technology Achievement Index (TAI), Finland is the world leader, followed by the USA and Sweden. It thus makes sense to talk about ‘a Nordic model of the information society’. To shed light on the model, combining a dynamic ‘information economy’ with the welfare state as its foundation, Himanen analyses Finland in depth, and thus gives a concrete content to the idea.

Himanen traces two factors that have contributed to Finnish success. First the key element is the interaction between *business and the state*, between the ‘information society’ and the welfare state. Although the Finnish model is market-driven, there has been a conscious government policy to push the Finnish business towards the ‘information economy’, e.g. a Science and Technology Policy Council was formed in 1986. Secondly, Himanen shows that the Finnish government has deliberately invested in research and development (R&D). By 2000, the national R&D investment exceeded 3 per cent of GDP and is currently close to 4 per cent, the highest in the world (with Sweden) and almost double the average in other advanced economies. Thirdly, Himanen refers to the fact that Finland’s public education system provides highly skilled people to drive innovation in IT ‘cluster’. It has also helped to create a special culture of innovation – the *open-source culture* – that has been the basis of key technological innovations. The Finnish welfare state has supported this innovation culture; the free and public education system, in which university students receive a small student salary, allows students to explore new ideas and applications, as they do not have an immediate pressure to graduate to earn a living.

Himanen points out that up to now the Finnish model has continued to work well, even during the late 1990s downturn of the IT field and the world economy. Relative to its competitors, both the Finnish economy and the leading technology companies, such as Nokia, managed recession better. However, Himanen warns of several problems that the Finnish model

may come to suffer. First, the level of *start-up entrepreneurialism* is relatively low: entrepreneurialism could be an important way of expanding technological innovativeness to completely new areas and thus broadening the basis for future growth. Second, *openness to foreign talent* is relatively weak. Third, global competition for talented and high-skill workers may increase pressures towards higher income inequalities; the central issue is how to balance equality issues with a courageous policy to create more work and make employment more profitable to both companies and the workforce. Finally, the *structures of the welfare state* have not been ‘upgraded’ to the ‘information age’. While the Finnish ‘information economy’ has reformed its work and management culture and used IT innovatively to increase productivity, the public services sector has reacted much more slowly. As the population ages, the pressure on the costs of the welfare state will become stronger and there will need to be productivity growth to avoid the cutting of services. One solution to these problems Himanen offers is the so-called ‘E-welfare state’, that would exploit the innovative potential of the well-educated workers in the public sector, linking up with ideas from the private sector and the workforce. Ultimately, the future of the Nordic model of a ‘virtuous cycle’ between the ‘information society’ and the welfare state will depend on each country’s ability, and courage, to reform its welfare state into an ‘E-welfare state’.

The current challenges to social policy in the Nordic countries are discussed by Olli Kangas and Joakim Palme in Chapter 12, ‘Does the Most Brilliant Future of the “Nordic Model” have to be in the Past?’ This final chapter is intended to be future oriented in three different ways. First, it describes the pension reforms that have taken place in the Nordic region, examining primarily the Finnish and Swedish cases. The changes have long-term consequences for the sustainability and scope of public intervention in the pension area. Secondly, it reviews the ‘universality’ of the Nordic welfare states, paying special attention to the areas where both principles and practices appear to be threatened by erosion. Thirdly, it tries to take a ‘holistic approach’ to social policy developments, starting from the observation that the old Keynesian legacy has disappeared and that we must find new macro-micro linkages in both design and evaluation of policies. The chapter tries to outline some basic principles that are congruent with a developmental perspective on social policy.

The basic argument is that the sustainability of the Nordic model of social policy hinges on the number of taxpayers that can be mobilized. In order to be successful, governments need to take a combined, or ‘holistic’ approach, and consider both micro motives and macro considerations. Incentive structures need to be improved: investment in human capital and social services are critical for both labour supply and productivity improvements. However, unless such measures are combined with successful macroeconomic policies they are unlikely to achieve anything close to their full potential.

## Note

- 1 In principle, there are five Nordic countries: Denmark, Finland, Iceland, Norway, and Sweden. Iceland is omitted here, mainly because of lack of availability of data. In a strict sense, the concept of 'Scandinavia' covers only Denmark, Norway and Sweden. Here we, however, use 'Nordic' and 'Scandinavia' as interchangeable concepts.

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