

Whither Social Europe?

Jonas Pontusson

Can egalitarianism itself contribute to growth? This political scientist looks at the recent success of the Nordic states and answers “yes.” He also cites other characteristics that have made the Nordic economies work, not least their investment in education and policies to promote female employment.

IT IS COMMON THESE DAYS to speak of a European social model and to ponder whether this model can survive as international competition intensifies, the world economy becomes more and more integrated, and capital becomes increasingly footloose. According to statistics on gross domestic product (GDP) per capita, Americans enjoy a much higher average living standard than the Germans and the French, but such statistics fail to take the distribution of income into account. It is by no means clear that the *median* German or French family is significantly worse off than the *median* American household, let alone the median British household. Still, there is no gainsaying that the core economies of the European Union have grown more slowly than the U.S. and British economies since the early 1990s and that growth rates do, over the long run, affect the living standards of the median household. And there is every reason to believe that slow growth erodes social solidarity or, in other words, political support

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for the welfare state. The political viability of “Social Europe” clearly depends on its economic viability.

Neoliberals typically invoke excessive egalitarianism to explain why Europe’s “social market economies” have performed worse than the “liberal market economies” of the United States and others in recent years. The refrain is familiar, indeed somewhat tired: strong unions and generous social safety-net provisions keep the wages of unskilled workers artificially high, dampening employment growth, and a whole series of redistributive policies undermine the incentives that are necessary to motivate individuals to acquire skills, to work hard, to innovate, to save and invest, and to start new businesses.

My first objective in this essay is to contest the view that egalitarianism is the source of Europe’s relative poor economic performance. The proponents of this interpretation typically engage in comparisons that juxtapose the United States to the European Union as a whole. The obvious problem with this approach is that it ignores variation in economic performance among EU member states. As I demonstrate below, cross-national comparison provides no support whatsoever for the proposition that more egalitarian countries have grown more slowly than less egalitarian countries, nor does it confirm the proposition that social spending is bad for economic growth. The Nordic countries are the social market economies with the largest welfare states and the most egalitarian distribution of income, and these economies have also performed significantly better than the social market economies of continental Europe since the early 1990s.

My second objective is to suggest that the concept of “Social Europe” is ambiguous. For political as well as analytical purposes, it seems useful to distinguish two different “social models” or, in other words, two different visions for Social Europe: the Nordic model on the one hand and the continental model on the other. The distinction between these models is not categorical but rather a matter of emphasis. Both models protect individuals against market risks, but the Nordic model emphasizes social equality while the continental model emphasizes social stability (cf. Esping-Andersen 1990). The evidence presented below suggests that the Nordic model represents

not only the more progressive but also the more viable alternative to neoliberalism.

Comparative Economic Performance

For the main countries of Western Europe and the Anglophone world, the first column of Table 1 reports on the growth of real GDP per capita (based on “purchasing power parities”) from 1994 to 2005. The second column reports of the growth of total employment, measured in terms of hours worked, over the same ten-year period. With respect to GDP growth, the Irish experience is truly outstanding. From 1994 to 2004, Irish GDP per capita nearly doubled, increasing by 89 percent (or, on average, by about 6.5 percent per year). At the other end of the spectrum, Switzerland stands out as the country with the most sluggish growth performance, falling below an annual growth rate of 1 percent. Leaving aside Spain, a latecomer like Ireland, continental Europe has consistently lagged behind the Anglophone countries, but this does not hold for the Nordic countries. Finland, Sweden, and Norway have experienced more rapid growth of GDP per capita than the United States over the last ten years. Finland and Sweden have even outperformed the United Kingdom, the Anglophone country with the second-fastest growth rate.

There are three notable exceptions to the proposition that employment growth is the special forte of liberal market economies: On the one hand, employment growth in the United Kingdom has been sluggish by the standards of liberal market economies, and, on the other hand, Spain and the Netherlands achieved very rapid growth of total employment during this period. Disregarding these three cases, it quite apparent from Table 1 that the Anglophone countries have achieved more rapid employment growth than continental Europe, and the Nordic countries look more like continental Europe than the Anglophone countries in this regard. Table 1 thus raises two puzzles. First, why has GDP growth in continental Europe, but not the Nordic countries, lagged behind that of the liberal market economies? Second, why has employment in many European countries, including the Nor-

Table I. Selected Indicators of Economic Performance (1994–2004), in percent

	Growth of real GDP per capita (PPP)	Growth of total employment (hours)
Anglophone countries		
Australia	27.7	17.4
Canada	25.9	20.0
Ireland	88.9	36.1
New Zealand	23.7	22.5
United Kingdom	28.6	6.1
United States	23.4	10.8
Nordic countries		
Denmark	18.8	9.7
Finland	38.6	11.0
Norway	27.1	6.4
Sweden	29.4	4.9
Continental Europe		
Austria	20.9	n.a.
Belgium	20.4	9.8
France	19.8	1.9
Germany	14.1	-6.8
Italy	15.5	5.4
Netherlands	20.6	19.1
Spain	30.7	43.9
Switzerland	7.6	-0.1

Sources: GDP growth based on data in <<FF are not in the ref list; please supply full citations>> OECD, *National Accounts*, vol. I (2006), 332–33; employment growth based on total employment from OECD, *Labour Force Statistics* (2005), 18–19; and average hours per employed person from OECD, *Employment Outlook* (2006): 265.

dic countries, lagged behind that of the liberal market economies?

From a European point of view, it is tempting to disregard comparisons of employment growth and to focus instead on comparisons of GDP growth. Consider two economies in which GDP per capita grows by the same amount: everything being equal, we would presumably consider the economy that achieves this increase of output with less increase of employment to be the superior of the two economies. There is clearly a dark side to employment growth in the United States's and other liberal market economies, with low-income households taking

on additional jobs or working more hours in the same jobs to compensate themselves for declining relative wages, and also sometimes declining real wages, and loss of public income support.

The United Kingdom and the Nordic countries might be said to have been singularly successful, combining Anglophone rates of GDP growth with continental European rates of employment growth, but sluggish employment is and indeed should be a source of concern for these countries. As Kenworthy and Pontusson (2005) demonstrate, sluggish employment growth is typically associated with growing inequality of market income (and this was clearly true for the Nordic countries in the 1990s). Over the short run, income transfers financed by redistributive taxes might compensate for this outcome, but everything we know about the politics of redistribution indicates that ongoing transfers from employed individuals to permanently unemployed individuals of working age do not represent a viable formula for the long run. This conclusion, of course, is particularly true in the context of an aging population and the fiscal challenges it entails.

Are egalitarian wage setting and redistributive welfare states really responsible for slow growth of GDP and employment, as neoliberal critics of Social Europe assert? The evidence presented in Figures 1–4 casts considerable doubt on this diagnosis. Figure 1 plots growth of GDP per capita over the period 1994–2004 against wage inequality in the mid-1990s, and Figure 2 plots employment growth against the same observations of wage inequality.¹ Wage inequality is here measured as the 90–10 ratio for gross (pre-tax) earnings of full-time employees, i.e., the ratio of earnings of someone at the bottom of the top 10 percent to the earnings of someone at the top of the bottom 10 percent of the earnings distribution.²

Ireland turns out to be not only the best performer on GDP growth by far, but also one of the Organization for Economic Cooperation and Development (OECD) countries with the most unequal distribution of wages. However, the overall picture conveyed by Figure 1 clearly suggests that inequality cannot be the main explanation for the Irish miracle. Ignoring the Irish case, there is no indication whatsoever in Figure 1 that wage inequality is associated with more rapid eco-

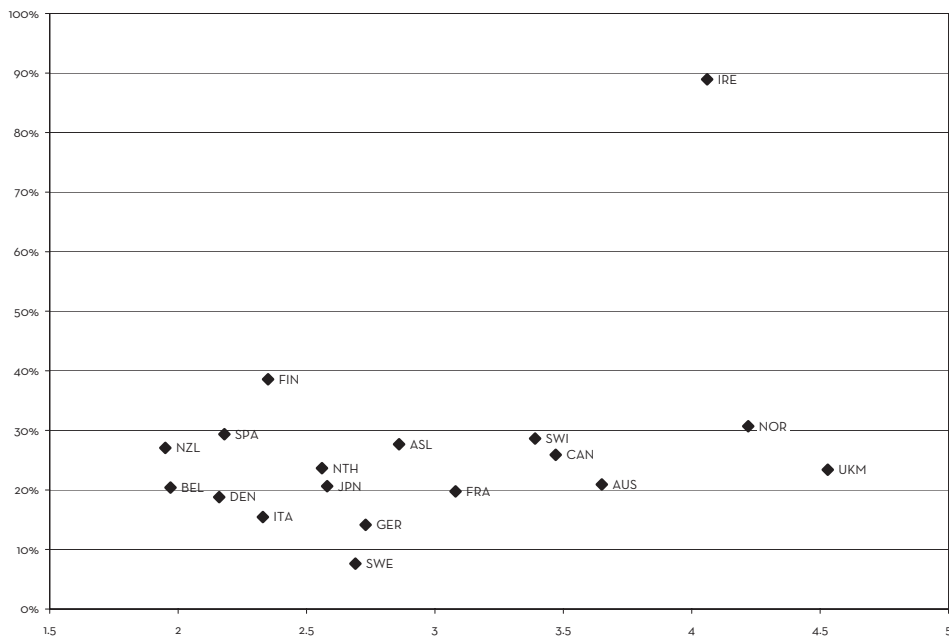


FIGURE 1. Real Growth of GDP per Capita 1994–2004 vs. Wage Inequality (90–10 Wage Ratios) Around 1994

Source: 90–10 ratios from OECD Directorate for Education, Employment, Labour and Social Affairs (electronic database). <<need full citation>>

conomic growth. Belgium, New Zealand, the Netherlands, Austria, and the United States cover the entire range of wage inequality among OECD countries, yet all fall within the range of 20–24 percent growth of GDP per capita. Even more striking, Figure 2 provides precious little support for the idea that compressed wage differentials tend to be an obstacle to employment growth. Rapid employment growth in Spain and Ireland is certainly consistent with this view, but the other countries do not line up as they should.³

Figures 1 and 2 should not be interpreted as evidence against the proposition that individual incentives are important for economic growth. The takeaway point is rather that aggregate measures of inequality do not capture the structure of incentives very well. The concept of “incentives” implies that individuals are able to adjust their behavior in response to observable differences in rewards. As

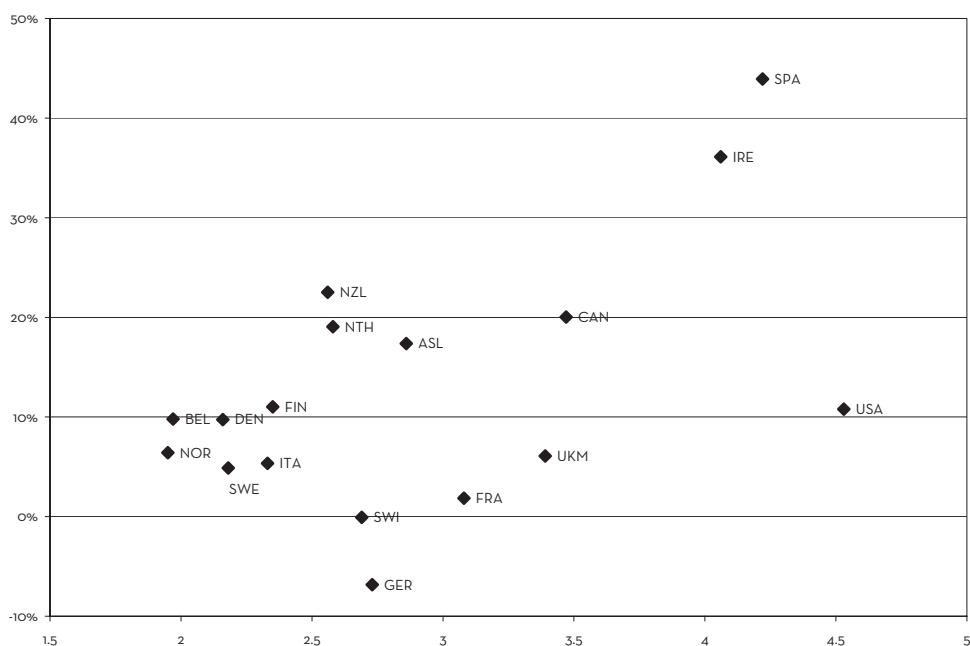


FIGURE 2. Employment Growth (in Hours) 1994–2004 vs. Wage Inequality (90–10 Wage Ratios) Around 1994

Sources: See Table I and Figure I.

mainstream economists would readily agree, inequality should not be expected to promote growth to the extent that it results from the exercise of power and/or involves some form of “categorical discrimination”—for instance, discrimination against immigrants or women. In short, it is necessary to distinguish between “productive” and “nonproductive” income differentials. Returns to education or training constitute the most obvious example of observable incentives that can be expected to increase the productive potential of an economy, but this example also suggests that public policies affect the size of incentives necessary to alter the behavior of individuals. Public funding of tertiary education must surely reduce the income differentials necessary to increase the supply of university graduates.

Thus there are at least two potential—and complementary—ways to explain the absence of any association between inequality and growth that are consistent with the emphasis on individual incentives in

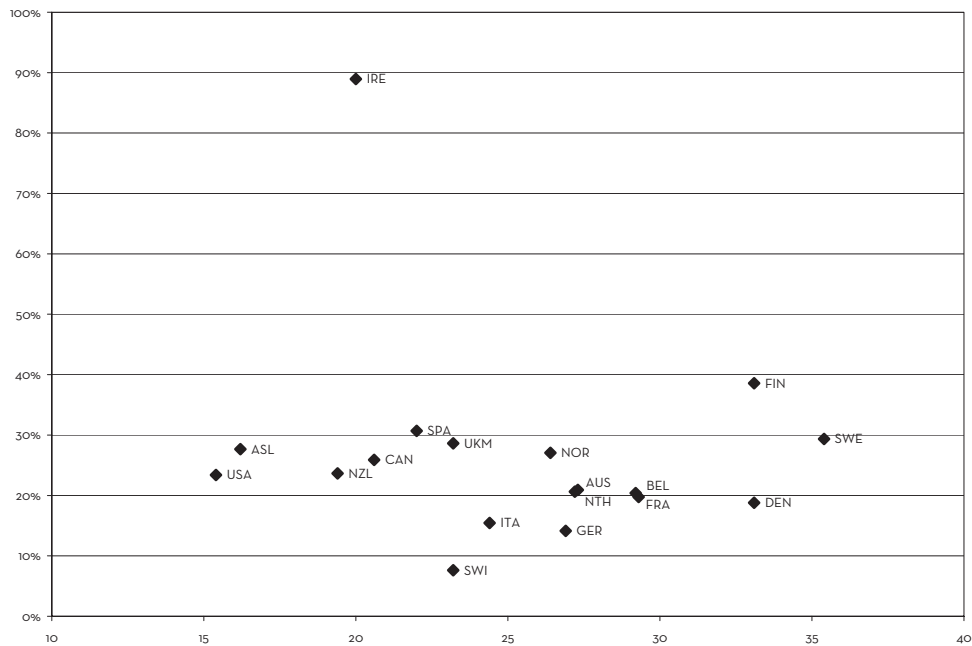


FIGURE 3. Real Growth of GDP per Capita 1994–2004 vs. Public Social Spending as a Share of GDP in 1994

Source: OECD, Social Expenditures Database (www.oecd.org/els/social/expenditure/).

mainstream economics. First, income differentials in countries with more equal distributions of income may be more productive. Second, countries with more egalitarian distributions of income may have developed public policies that offset whatever disincentive effects egalitarianism might entail.

Some economists argue that it is not egalitarianism itself but rather government efforts to redistribute income that represent an obstacle to economic growth. More generally, it is commonplace to argue that deadweight losses are associated with high taxes and that high marginal income taxes as well as generous welfare benefits constitute growth-dampening disincentives. As a crude test of such arguments, Figure 3 plots the growth of GDP per capita over 1994–2004 against public spending on social programs as a percentage of GDP in 1994, and Figure 4 in turn plots employment growth against social spending. Akin to the absence of any association between inequality and

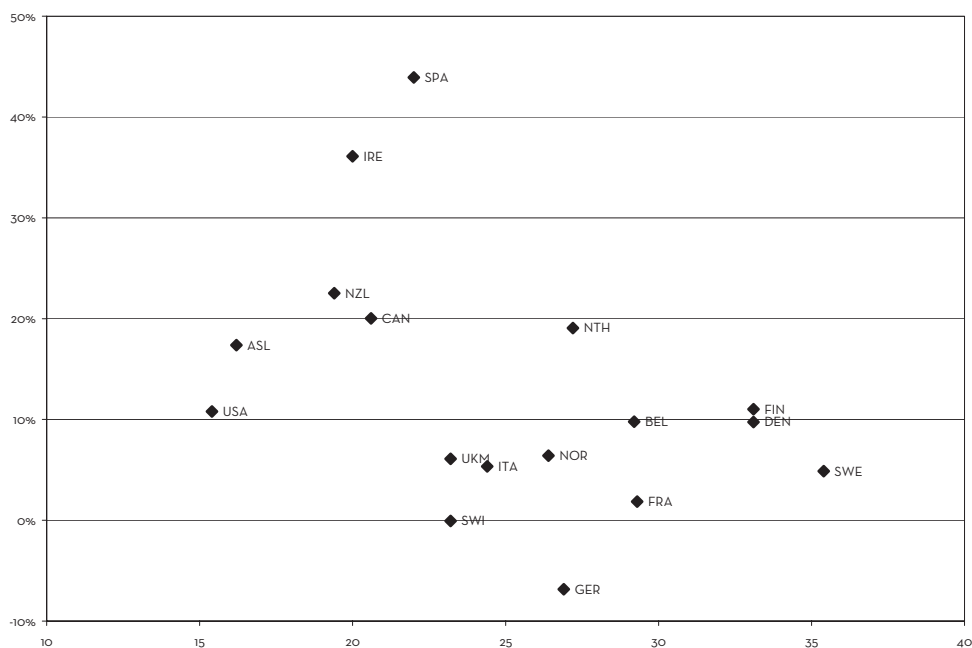


FIGURE 4. Employment Growth (in Hours) 1994–2004 vs. Public Social Spending as a Share of GDP in 1994

Sources: See Table 1 and Figure 3.

growth, there is no indication in Figure 3 that countries with large welfare states have generally grown more slowly than countries with small welfare states. Figure 4 provides some indication that social spending may have prevented GDP growth from translating into employment growth, but the evidence on this score is hardly conclusive. The bottom line is this: Unemployment insurance and other social programs may well entail disincentive effects, but the extent of such effects depends on specific program characteristics. To conceive of the problem of disincentives in terms of “big versus small welfare states” is not very meaningful.

In short, then, egalitarianism does not seem to take us very far toward an explanation of cross-national differences in GDP growth and employment growth. At best, cross-national variation in the size of the welfare state provides some limited leverage for explaining differential rates of employment growth.⁴ If egalitarianism does not

explain these outcomes country by country, it cannot possibly explain aggregate differences between the United States and Europe (or, alternatively, between liberal and social market economies). What other factors must be considered then? Let me indicate what I consider the prime suspects.

To begin with, macroeconomic management obviously must be taken into account. Preparations for the launch of the European Monetary Union (EMU) and its early stages have been associated with a highly restrictive monetary policy stance not only in the countries that have formally joined the euro, but across Western Europe. The process of European integration also appears to have generated a bias in favor of restrictive fiscal policy. Though neoliberalism has been more successful as a political project in the Anglophone countries, the macroeconomic policies of the continental and Nordic social market economies have largely conformed to neoliberal prescriptions over the last fifteen years (possibly even more so than the macroeconomic policies of the Anglophone countries).

With respect to microeconomic issues, I am inclined to believe that employment protection and heavy reliance on payroll taxes to finance social insurance schemes constitute more important obstacles to employment growth in continental Europe and the Nordic countries than do strong unions and compressed wage differentials. European employment regulations clearly do impose costs and obligations on firms, and it stands to reason that firms have sought to avoid these costs and obligations by finding ways to grow that do not involve an increase of permanent employees (productivity growth, overtime, temporary workers). Proponents of strict employment protection do not deny this; rather, their position is that the benefits of employment protection outweigh the costs. The question becomes whether there are other ways to protect workers against the vicissitudes of the market economy, with less negative employment consequences.

As for payroll taxes, Fritz Scharpf (2000) argues persuasively that the burden of proportionate labor taxes falls on less-productive jobs and that reliance on such taxes therefore dampens employment growth in private services. Scharpf's analysis suggests that Nordic and continental

social market economies might be able to boost employment growth by shifting the financing of public welfare programs from payroll to income taxes. Greater reliance on general tax revenues, as opposed to earmarked social security contributions, also enables welfare states to respond more effectively to new social needs associated with the decline of the “male-breadwinner household.”

Finally, extensive regulation of product markets and capital markets represents potential obstacles to economic growth in continental Europe. It is well documented, for example, that starting new businesses is more costly in most European countries than in the Anglophone countries, quite apart from the “social” costs and obligations involved. Also, it appears to be the case that small, fast-growing companies have a more difficult time in obtaining external financing than they do in the United States and are therefore less likely to become medium-sized companies. To my mind, there is no obvious, truly compelling reason to suppose that liberalizing or deregulatory reforms of these realms pose a direct threat to the core objectives that proponents of Social Europe care about.

The Return of the Nordic Model(s)

Widely admired abroad, the economic and social policies developed by Scandinavian Social Democrats in the 1960s and 1970s seemed to run out of steam in the 1980s. All four of the Nordic countries, but especially Sweden and Finland, were severely hit by the international recession of the early 1990s. As we have seen, however, the Nordic economies have since performed very strongly as far as growth of GDP per capita is concerned. From 1994 to 2004, GDP growth in Finland and Sweden exceeded that in all other industrialized countries except Ireland and Spain. Employment growth lagged behind many other countries, but both countries have brought unemployment down to manageable proportions. With 70–72 percent of the working-age population being employed, Denmark, Norway, and Sweden still have the highest employment rates of any of the industrialized countries. It is also noteworthy that the Nordic countries hold four of the top ten places in the World

Economic Forum's most recent (2005) rankings by "Growth Competitiveness," an index that takes into account human capital and other resources related to technological innovation, the quality of public institutions, as well as the macroeconomic environment.⁵

The Nordic political economies have changed in many ways since the early 1990s, yet the two things that were typically singled out as their most distinctive features in the 1970s remain so today: compressed wage differentials and large, redistributive welfare states. The evidence presented above suggests that these features are compatible with economic success in the new world economy. In this section, I want to take a further step by suggesting that egalitarianism forms an integral part of the Nordic success story over the past ten to fifteen years, or, in other words, that it has contributed positively to the success of the Nordic economies.⁶

The distinctively compressed wage structures of the Nordic countries can be attributed in part to the enduring strength of organized labor and the solidaristic approach to wage bargaining adopted by Nordic unions. The Nordic labor movements embraced the idea of "solidaristic wage policy" as part of a long-term, political-economic strategy in the 1950s and 1960s. The policy involved raising wages at the lower end and restraining them at the upper end. The logic behind this strategy was famously articulated by two economists working for the Swedish Landsorganisationen i Sverige (LO—Swedish Trade Union Confederation) at the time, Gösta Rehn and Rudolf Meidner. The "Rehn-Meidner model" linked productivity growth in the economy as a whole to the redistributive interests of low-wage workers. On the one hand, a concerted union effort to provide low-wage workers with higher wage increases than market forces dictated would squeeze the profits of less efficient firms (sectors) and force them either to rationalize production or go out of business. On the other hand, wage restraint by well-paid workers would promote the expansion of more efficient firms (sectors). The net effect of this differentiated pressure on firms would be to raise average productivity in the economy and thereby make it possible for average wages to rise without threatening macroeconomic stability.

The insight at the core of this strategic vision is the idea that low wages represent a subsidy to inefficient capital. At the same time, Rehn and Meidner clearly recognized that wage differentials were necessary as an incentive for workers to acquire skills and to take on more responsibility in the production process. The goal of union wage policy should be to eliminate differentials based on corporate profitability while maintaining differentials based on skill and performance. In other words, the goal of union wage policy should be “equal pay for equal work,” as distinct from “equal pay for everyone.” Occupational pay differences would remain; differences paid the same occupations by different companies would be minimized.

In practice, it proved difficult for Nordic unions to maintain the distinction between productive and nonproductive wage differentials. At least in the Swedish case, solidaristic wage policy became too egalitarian in the course of the 1970s, producing a generalized profits squeeze and, ultimately, an employer campaign to decentralize wage bargaining and bring down the solidaristic model. However, Nordic unions have continued to resist interfirm dispersion of wages, and this stance has arguably contributed to strong productivity growth since the early 1990s and, above all, the expansion of knowledge- and technology-intensive sectors. Indeed, it is tempting to argue that more decentralized forms of wage bargaining in Sweden, Denmark, and Finland have promoted a return to the original principle of compressing interfirm differentials rather than interoccupational differentials. Be that as it may, the insights of the Rehn-Meidner model remain relevant and extend beyond the Nordic experience. In particular, the idea that low wages represent a subsidy to inefficient capital casts a critical light on the expansion of low-paying service jobs in liberal market economies and the rhetoric of neoliberalism.

Active labor market policies were an integral part of the Rehn-Meidner model, serving to ease the transition of workers from less efficient to more efficient firms and sectors and also to curtail wage drift caused by bottlenecks in the supply of labor. Over the last two decades, other countries have developed active social policies to benefit labor, and, as a result, the Nordic countries no longer stand out

so clearly in terms of the resources they devote to such policies. (As a share of GDP, the Netherlands spent more on active labor market policies than Sweden, Finland, or Norway did in 2004). Active labor market policy nonetheless remains an important component of the Nordic policy mix.

It is common for labor economists as well as more casual observers in the Nordic countries to argue that government-administered retraining programs have not been particularly effective and often serve simply to hide the unemployed. As space does not permit a detailed examination of the issues involved here, a few quick remarks must suffice. It should first be noted that (re)training constitutes but one component of active labor market policy (accounting for less than one-third of government spending on active labor-market measures in the Swedish case). More importantly, active labor market policy does not by itself constitute an "employment strategy"; rather, it constitutes a set of supportive programs, the effectiveness of which depends on employment growth generated by other means. We should not expect government spending on active labor market policies to increase the rate of employment growth, but we might expect it to reduce the average duration of unemployment spells and thereby, indirectly and over the long run, affect the rate of unemployment. The cross-national evidence is indeed consistent with these expectations (Pontusson 2005, 129–30). Put differently, the distinctive contribution of active labor market policy to the success of the Nordic economies has to do with their ability to avoid getting stuck in a high-unemployment trap in the 1990s.⁷

From a comparative perspective, public investment in general education constitutes another outstanding feature of the Nordic countries. According to the most recent OECD figures available, referring to 2001, Denmark, Norway, and Sweden spend more of their GDP on education than any other OECD countries. The gap between these countries increases when the comparison is restricted to public spending and again when the comparison is further restricted to public spending on primary and secondary education. (Finland ranks fifth, behind Belgium, in terms of public spending on all levels of education.) Apparently

related to this distinctive pattern of education spending, the Nordic countries are also characterized by a strikingly egalitarian distribution of literacy and other basic skills (*ibid.*, 134–40). The complementarities between solidaristic wage policy and egalitarian education policies deserve to be emphasized. The compressed distribution of educational achievement has contributed directly to the compressed distribution of wages, pushing in the same direction as union wage policies (and helping to explain why wage differentials have remained fairly stable as wage bargaining has become more decentralized). At the same time, higher basic skills at the lower end of the skills hierarchy has made it easier for Nordic firms to achieve productivity growth with low-skill workers or, in other words, to cope with the consequences of solidaristic wage policy.

The egalitarian thrust of postwar education reforms in the Nordic countries involved a shift away from German-style, apprenticeship-based vocational training. Particularly pronounced in the Swedish case, and least pronounced in the Danish case, this shift coincided with development of Fordist mass production methods and has arguably posed an obstacle to the development of diversified-quality production methods within the manufacturing sector. From this perspective, the “post-industrial” profile of the growth trajectory of the Nordic economies since the crisis of the early 1990s becomes important. Again, high levels of educational achievement at the lower end of the skill hierarchy have made it possible to achieve significant productivity growth across a wide range of public as well as private services. Arguably, the Nordic approach to education also constitutes an important condition behind the distinctive pattern of broad-based IT consumer sophistication that has commonly been noted by foreign observers (more cell phones per capita, more Internet connectivity, etc.).

Policies to promote gender equality and, in particular, to encourage women’s employment during child rearing constitute another characteristic that the Nordic countries have in common and that distinguish them from other OECD countries, most notably the social market economies of continental Europe. The standard argument that discrimination interferes with the optimal allocation of talent suffices

to suggest how gender equality might be said to have boosted the growth potential of the Nordic economies. High employment rates for women as well as for men certainly place these countries in a much stronger position to deal with the problem of population aging than that of other European countries. Furthermore, it deserves to be noted that Nordic policies related to families and female labor force participation benefit children, at least the children of low-income families. Along with Belgium and France, the four Nordic countries are the only OECD countries in which the poverty rate for children below the age of sixteen is lower than the poverty rate for the population as a whole (*ibid.*, 160).

Needless to say, perhaps, the concept of the Nordic model also encompasses a particular approach to the public provision of social welfare, emphasizing universalism and public services. In the existing literature, this approach is typically juxtaposed to the (Bismarckian) social-insurance approach of continental Europe. The economic crisis of the early 1990s triggered drastic cutbacks in public-sector employment in Sweden and entitlement cuts in the other Nordic countries as well. As unemployment and poverty increased, the share of the population drawing some form of means-tested social assistance increased. At the time, a number of commentators, myself included, interpreted these developments as a major (perhaps irreversible) retreat from universalism and suggested that the political legitimacy of welfare programs based on social citizenship is more precarious than that of welfare programs based on the insurance principle. As the economic recovery gathered momentum in the second half of the 1990s, however, Sweden's new Social Democratic government restored funding to the public sector, and other Nordic governments also shored up their social welfare systems. The legitimacy of universal welfare entitlements today appears to be as strong as it has ever been in the Nordic countries, while continental welfare states continue to struggle with the dual challenges of equity and financing in the face of demographic changes and sluggish employment growth.

Finally, I want to emphasize that high levels of employment protection are *not* a feature that distinguishes the apparently "worker-

friendly” Nordic countries from continental Europe. In the 1950s and 1960s, the Swedish and Danish labor movements and their Social Democratic allies explicitly rejected the idea that the government could and should provide workers with security in their current jobs. The official motto of Swedish Social Democracy at this time was to provide for “security in the labor market,” as distinct from employment or job security, meaning that the state would provide income support and retraining opportunities for unemployed workers and that it would also protect workers against unfair dismissal, but it would not interfere with layoffs motivated by business considerations. In the context of severe industrial adjustment problems, the Swedish labor movement embraced employment protection in the 1970s, but this should be seen as an essentially pragmatic-defensive move (rather than a principled conversion). As measured by various OECD indices, employment regulations on continental Europe are typically stricter than employment regulations in the Nordic countries. And Denmark stands out, along with Switzerland, as the social market economy with the least restrictive rules governing dismissals and layoffs. To reiterate, the policies that distinguish the Nordic approach to “regulating capitalism” are motivated by egalitarianism rather than resistance to market-driven economic restructuring.

Two Visions for Social Europe

The “U.S.-versus-Europe” debate often seems to boil down to assertions of identity—American societal values (individualism) being juxtaposed to European societal values (solidarism?). It is surely important to contest American triumphalism in this “war of the models,” but asserting common values shared across a broad range of European political forces often serves to paper over important differences in policy and ideology. To my mind, such differences should be debated more strenuously and more broadly than is currently the case. This second debate is a debate about what the social objectives of progressive Europeans should be and how capitalism might be

managed to achieve these objectives. It is a debate that strikes me as much more interesting and potentially more consequential than the “U.S.-versus-Europe” debate.

One obvious way to advance the debate about alternatives for Social Europe is to revisit the Nordic model, to ask whether the success of the Nordic economies over the last decade is sustainable, and to inquire about the lessons other European countries might draw from the Nordic experience. As articulated above, the Nordic model rests on the view that equality and prosperity are compatible, that market forces are largely benign, and that it is desirable to avoid government interference with business decisions. There are good reasons to be skeptical about this quintessentially social democratic point of view, but it is hard to argue with the recent success of the Nordic economies. Most important, I want to challenge the skeptics to articulate an equally coherent, principled vision of what Social Europe should be about and how it might work.

One important qualification about the Nordic model is in order. I have emphasized that the Nordic model assigns the societal costs of adjusting to market pressures for change to the government rather than firms and that it avoids detailed government interference with business decisions. However, it is not quite accurate to say that Nordic Social Democrats have adopted a *laissez-faire* attitude toward business decisions. This formulation misses the important role that collective bargaining plays in the Nordic approach to “regulating capitalism.” Broadly speaking, many of the employment issues that have been handled by means of legislation and government regulation on the continent have been handled by bargaining between unions and employers in the Nordic countries. This raises the interesting question of why “regulation by bargaining” might be preferable to “regulation by legislation” (from the point of view of economic outcomes, such as GDP growth and employment growth). I am not prepared to tackle this question at the moment. The simple point I want to make here is that the Nordic model presupposes relatively strong unions, with the capacity and inclination to engage in bargaining with employers across a wide range of social issues, in addition to wages. In this sense,

the generalizability of the Nordic model is obviously limited.

It should also be underlined that the Nordic model entails “big government” in the sense of a large share of economic resources’ being channeled through the public sector. From this point of view, it is hardly surprising that social policy debate at the EU level has proceeded almost entirely along continental lines, focusing on regulation of employment relations from above. In countries with weak and fragmented unions and in the arena of the European Union, the continental vision of Social Europe enjoys obvious political advantages over the Nordic vision. This said, the pragmatic, multifaceted nature of the Nordic approach should be emphasized. Coordinated wage bargaining to curtail profit-generated wage differentials, public investment in education, active labor market measures and measures to allow families to reconcile work and child-rearing—each of these policies can be expected to have beneficial effects even in the absence of the others and even in small doses.

The debate that I wish to promote is about concrete policy choices as much as it is about ideological visions. Over the last two decades, governments across Western Europe—governments of the left as well as the right—have cut back on income support for the unemployed while resisting demands to relax rules governing dismissals and layoffs of permanent employees. The political logic behind this policy orientation is easy to comprehend, given that employed workers are more likely to vote and otherwise participate in politics than unemployed workers are. From the Nordic perspective that presented here, however, this policy represents exactly the wrong priorities: protecting insiders at the expense of outsiders and shifting the burden of social protection from the government to individual firms. Reversing these priorities strikes me as a good way to think about incremental reforms that would strengthen Europe’s social market economies and, at the same time, counteract inegalitarian trends.

Notes

. Economic growth may well affect wage inequality and redistributive social spending. By plotting growth against levels of inequality and spending prior to the

period for which growth is measured, these figures avoid the problem of “reverse causality.” Note also that controlling for initial levels of GDP per capita do not affect the picture conveyed by these and subsequent figures.

2. Plotting GDP and employment growth against various measures of income inequality among working-age households yields essentially the same pictures as those shown in Figures 1 and 2. The advantage of using wage inequality on the horizontal axis is that more countries are part of the picture.

3. Note that this also holds with 50–10 wage ratios on the horizontal axis (i.e., measuring wage dispersion only for the bottom half of the distribution).

4. Across the countries included in the preceding graphs, there is no association whatsoever between employment rates (the percentage of the population between fifteen and sixty-four in gainful employment) in 2005 and either levels of wage inequality in 2002–3 or levels of social spending (as a share of GDP) in 2001.

5. Finland ranks first, the United States second, Sweden third, Denmark fourth and Norway tenth. On a separate index pertaining to the quality of the national business environment, Finland still ranks first and Denmark ranks third, but Sweden drops to fourteenth and Norway to twenty-first place. See www.weforum.org.

6. By contrast, a recent report by the National Bureau of Economic Research (NBER) and a business-sponsored Swedish think tank (Freeman et al. 2006) frames Sweden’s economic success as a puzzle and argues that growth provides an opportunity to build down the welfare state and promote more inequality.

7. Finnish unemployment peaked at 16.8 percent in 1994 and had subsequently dropped to 8.4 percent by 2005. Swedish unemployment peaked at 9.9 percent in 1997 and had dropped to 5.6 percent by 2005. Unemployment rates remain high in these countries. The key point I want to stress here is that they have avoided the continental scenario of each new recession ratcheting up the “equilibrium rate of unemployment.”

For Further Reading

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