

W O R K I N G P A P E R

*The Scandinavian Experience
Trajectories of Adjustment –
Experiences, Lessons and Perspectives*

Niels Ploug

*Comparative Welfare State Research
Working Paper 8:2000*



The Danish National Institute of Social Research

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Revised version of a paper presented at the conference on: Europe, Globalisation and the Future of Social Policy. Lisbon, May 5-6, 2000

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Introduction¹⁾

Some years ago, at least some scholars thought that the Nordic countries had found an unexpectedly simple solution to the basic societal problem of combining social equality and economic efficiency. Subsequent to the Second World War, these countries had developed into welfare states, based in principle on citizens' rights and featuring universal coverage, liberal criteria for eligibility, comparatively high income replacement levels, comprehensiveness of services, etc. From the late 1950s, generous welfare benefits were developed in a context of rapid economic growth, low unemployment and high levels of participation in the labour force, particularly among women. These developments both contributed to and were caused by the gradual transformation towards a service-intensive welfare state. The apologists for the Nordic-style welfare state argued that Nordic countries in general, and Sweden in particular, had developed a unique capacity to introduce social reforms while simultaneously managing the economy in an effective way.

The characteristics of this supposedly successful welfare state – or what might be labelled as the 'Nordicness' of the Nordic welfare state – can when it comes to inputs (paragraphs 1-5) and outputs (paragraphs 6-7) be listed in the following way:

1. The scope of public social policy is large. It encompasses social security, services, education, housing, employment, etc. with an aim to meet most basic needs.
2. The State's involvement has been strong in all policy areas. The political commitment to full employment has been based on both macroeconomic and social policies. There is, of course, historical variation between the Nordic countries, but an emphasis on full employment nevertheless could be regarded as one trait. It is often accompanied by active labour market measures and tripartite wage-bargaining negotiations that sometimes have resulted in sociopolitical legislation as well.

1. The results presented in this paper is mainly based on results from the project 'Nordic Social Policy' reported in Kautto, Heikkilä, Hvinden, Marklund & Ploug (1999): *Nordic Social Policy – Changing Welfare States*, Routledge – and results from the Welfare Research Programme of the Danish National Institute of Social Research reported in Ploug & Søndergaard (1999): *Velfærdssamfundets fremtid*, Socialforskningsinstituttet.

3. The Nordic welfare system is based on a high degree of universalism, meaning that all citizens/residents are entitled to basic social security benefits and services, regardless of their position in the labour market. There are also targeted measures, but they are applied only as a last resort safety net. It is argued that universalism has contributed to wide public support for welfare policies.
4. Income security is based on two elements. In most schemes, there is a flat-rate basic security and an earnings-related part for those with a work history. The strength of the central organizations of employers and employees in administering earnings-related parts of social insurance varies in the Nordic countries. Compared to other industrialized countries, the Nordic countries can be characterized as transfer-heavy states. Thus the share of social expenditure of GNP has been high. As public financing of transfers has been considerable, the Nordic countries also had high taxation.
5. The Nordic countries have also been characterized as service states. The role of local democracy is strong. Social and health services are financed through taxation without high user fees, and are targeted at all residents in need. They are provided by the local authorities and also mostly produced by them.
6. Income distribution is relatively even. Both in terms of wage dispersion and disposal income, the Nordic countries have low income inequality compared to other countries. There are no big cleavages between different income groups. Partly for this reason poverty rates and differences in level of living have been relatively low.
7. Gender equality has been stated as one of the guiding principles of the Nordic welfare states. The Nordic countries have the broadest participation of women in wage-earning employment, and in most families there are two breadwinners. Social policy measures are based on individual rights, so women are not economically dependent on their husbands.

What from the outside might look like an idyllic picture – the best of all worlds to live in - had already started to crack in the mid-1970s. Following the first oil crisis, the Danish unemployment

rate began to rise from a low of 0.9 per cent in 1973 to 5.1 per cent in 1975 and continuing to a peak of 11.4 per cent in 1983. The OPEC oil price increase of 1973 did not affect the other Nordic countries to the same extent. Thanks to the country's huge oil reserves Norway was in a stronger position. On the other hand, the Norwegian economy was, and still is, suffering from a number of defects which are only partly masked by revenues from the State's oil sector. During the 1970s, the Governments of Sweden made use of a time-honoured 'Swedish-style' counter-cyclical policy supported by extensive active labour market policies combined with industrial policy measures. The corollary, however, was mounting public budgetary deficits, which proved to be the Achilles heel of the Swedish economy entering the 1990s. Finland was situated in the middle, with unemployment rates below those in Denmark but above the levels in Norway and Sweden. Finland's economic growth during the 1980s, however, was spectacular – the late 1980s being a particular prosperous period.

During the early 1990s, both the Swedish and Finnish economies had severe problems. In Sweden the unemployment rate started rising, and peaked at an unprecedented 8.2 per cent in 1993; this figure does not include those participating in active labour market measures. Growth halted and then took a negative turn over the years 1991-1993. Developments in Finland were even worse. The unemployment rate rocketed, hitting its peak of 17.7 per cent in 1993, and economic growth rates for the first years of the 1990s were strongly in the negative. Finland was extremely hard hit by the collapse of the former Soviet Union, but structural problems in the Finnish economy, caused in part by the intensive growth experienced in the late 1980s, are the basic reason for the severe economic and social problems that have faced Finland from the beginning of the 1990s. The currency policies of Finland, Norway and Sweden failed, and all were eventually forced to let the currency float.

Lessons from the 1980s and 1990s adjustment process

The background for the changes and reforms described in this section is the fact that the Nordic model, much praised in the past – as well as in the present – seemed in the 1980s and 1990s to be less effective. The economic problems associated with the issue of macroeconomic stability

and the related fiscal pressures called for re-evaluation of many of the arrangements worked out and developed during the prosperous years of the 1960s and 1970s.

The need for re-evaluation was especially keen because most Nordic politicians in the beginning of the 1990s did not consider it likely that unemployment rates would return to the lower levels of former years. This made it rather difficult to adhere to the institutional set-up devised in the past. Most schemes dated back to the 1960s, a decade characterized by low unemployment and high growth rates; they were amended during a period that most policy-makers considered to be only a temporary downturn. The generous benefit schemes of the past was causing increasing alarm. There was anxiety regard their effects on incentives and their impact on the structural problems of the labour market. There was also concern regarding the consequences that generous benefit schemes might have for public budgets in a situation where growing numbers of people collect benefits. As unemployment was rising, an increasing number of people became dependent on public support; in consequence, the tax base shrinks. Ultimately, an issue that started as an unemployment problem evolved into a problem for the entire welfare system.

The political response to these developments was to implement a number of changes in the welfare systems in the Nordic countries.

Of the Nordic countries Denmark has had the longest experience of unemployment crisis. Unemployment in Denmark has been at a fairly high level ever since the mid-1970s. For this reason, different parts of the cash benefit system – especially unemployment benefits and the social assistance scheme – have undergone a long chain of increments, partial revisions and amendments extending into the 1990s.

The labour market reform of 1994, the tax reform of 1994 and the social security reform of 1997 brought a halt to this line of increments and partial revisions, and all in all have led to the establishment of a new institutional framework on which the welfare system has been based for a number of years, and on which it will be based in the coming years.

The labour market reform of 1994 had, among others, the following implications for the Danish welfare system:

- The duration for which unemployment benefits could be granted was limited to seven years in 1995 and to five years in 1996.
- Eligibility for unemployment benefits, including eligibility for a new five-year period presupposes six months of non-supported employment in 1995 and twelve months of non-supported employment as of 1996.
- Members of unemployment benefit funds, whether employed or unemployed, were granted the right to take educational, parental or sabbatical leave lasting a maximum of 52 weeks.

The reform puts greater emphasis on active labour market policy, including an obligation for those unemployed to take part in employment measures and training programmes. Individual plans were made for each unemployed taking into account their resources and qualifications. The creation of transitional labour markets with an emphasis on the social responsibility of enterprises has been one important tool in trying to reduce marginalisation from the labour market. It is worth noting that the reform did not introduce changes in benefit levels.

The tax reform of 1994 had, among others, the implication that social assistance and state old-age pension, which previously were partly exempt from taxation were made taxable benefits. Benefit levels were, on average, raised more than correspondingly.

The social security reform of 1997 has no major implications when it comes to eligibility, benefit level, etc. for social assistance. However, it places greater emphasis on active employment measures, e.g. job training and education for recipients under the age of 30 – and benefits for those under 25 years of age were cut in half. These measures have resulted in a dramatic decrease in youth unemployment.

To sum up, these reforms have created a more transparent system with regard to the benefit level for persons of working age. All benefits are now measured as a percentage of the level of unemployment benefits, and they are all considered part of taxable income. The Government has called this revised system a system of ‘obligations and rights’, meaning that the system incorporates both an obligation to participate in active labour market measures – e.g. job training and education – and the right to do so in accordance with what is called the personal plan jointly drawn up by the individual unemployed person and the labour market office.

In the early 1990s Finland experienced severe economic difficulties. In the beginning of the 1990s, no cuts were made, on the contrary, increases based on decisions taken in the 1980s were still implemented. As unemployment climbed rapidly from 1991 to 1992 and onwards need arose to adapt the system to the economic reality.

Initially, most changes took the form of cost-cutting measures. The budget for 1992 made cuts to the unemployment benefits and the earnings-related sickness benefits; the latter indirectly led to cuts in the level of maternity, paternity and parent benefits, as these are linked to sickness benefits.

After three years of rising unemployment and cost-cutting measures, it was realised in 1994 the explosion of costs could not be curbed only by lowering the level of support. A new scheme for those entering the labour market for the first time – and for those who had collected earnings-related benefits for the maximum period of 500 days – was introduced with the function of securing a basic livelihood. In 1996, cuts were targeted at minimum-security benefits; for the first time, a whole group of people was excluded from support. People whose income fell below the ‘approved’ level were excluded from sickness benefits altogether. This meant in practice, that housewives and students – who had been entitled to collect sickness benefits at the minimum level – were excluded from the scheme. A number of additional cuts were introduced in the period thereafter.

The Finnish case can be seen as the closest one can get to a worst case scenario with an economy with negative growth in the GDP and a tripling of unemployment over a period of only three years. The lesson that can be drawn from this case is that even in this case it is possible to manage the situation without a dismantling of the welfare system, and in recent years the economic and employment situation in Finland has improved.

The Swedish case is somewhat similar to the Finnish in the way that Sweden experienced an economic recession at approximately the same time as Finland, i.e. in the beginning of the 1990s; but expansion of the Swedish welfare state came to a halt some years earlier, in 1988. The Swedish handling of the situation has also been somewhat similar to the Finnish, i.e. a number of cutbacks in the provision of benefits. The first cutback was announced in 1990 and implemented

in the beginning of 1991. As absence due to sickness had been a major problem in Sweden in the 1980s, cash benefits for sickness were a natural target for cutbacks. Benefit levels were reduced from 90 to 65 per cent for the first three days of absence, and to 80 per cent from day 4 to day 90. Major changes also took place in the unemployment insurance system. In 1993, the benefit level was reduced from 90 to 80 per cent of previous earnings, and the five-day waiting period which had been abolished in 1980 was re-introduced. As in Denmark it was made impossible to re-qualify for unemployment insurance merely by taking part in training programmes and relief work. And as early as 1991, it was decided that disability pension could no longer be granted on labour market grounds only.

The situation in Sweden never was as severe as in Finland but the problems took away some of the glamour that the Swedish model had in the 1980s. As in the Finnish case the economic and employment situation in Sweden has improved in recent years.

General observations on the reforms of the 1990s

It is hard to predict how the cutbacks and reforms of the 1990s of the welfare systems will affect the future development of these systems in the Nordic countries. A few observations, however, can be presented regarding the changes – or maybe even restructuring – that has taken place.

In a number of areas, cutbacks have been introduced. This process has involved cuts in benefit levels, tightening of eligibility criteria and shortening of benefit periods. In general, these cuts have not been radical – some of them can even be seen as symbolic – and on the macro-level the Nordic countries are still among those allocating the most resources to welfare. For the individual citizen, however, the cuts may have had dramatic effects. The tightening of eligibility criteria is a problem for people entering the systems, and the shortening of benefit periods is a problem for those hit hardest by long-term unemployment or sickness. In general, unemployment benefits, sickness benefits and social assistance have been the target of immediate cuts and changes, while the changes made to pension schemes are more long-term in nature.

The Nordic welfare states today are less generous than in the 1970s and 1980s, and social security for the individual citizen is on a lower level than it used to be, but the Nordic welfare systems are still quite generous. Compared to other welfare systems, universal coverage has been a marked feature of the Nordic welfare states. All in all, this is still the case, though some of the changes implemented in the 1980s and 1990s have added some nuances to the picture of universal coverage. Strictly speaking, the Danish old-age state pension is no longer universal but is means tested; and in Finland, specific groups have been excluded from the sickness benefit system.

As a solution to the problems of the welfare state, many economists have suggested the introduction of greater economic incentives into the cash benefit systems, especially with regard to unemployment. This consideration has surfaced in the ongoing discussion. In reality, however, not many changes in that direction have been made. Instead there has been a move towards so-called active measures. Social rights, such as the right to income support when unemployed, are increasingly being subject to question and there has been a shift towards requiring participation in job training or educational programmes as a condition for collecting benefits.

Pension schemes, in particular, have undergone a number of long-term reforms, the effects of which remain to be seen. But also in the sphere of unemployment, the introduction of obligations in order to be entitled to benefits has in some cases been one aspect of major reform.

A 'Mission impossible' for the Nordic welfare model?

In a broad context, one may ask whether these changes, as well as the overall problems facing the Nordic welfare states, indicate that the next system to topple after socialism will be Nordic exceptionalism. Recent developments contain little to point in that direction. Not many of the changes have been systemic. The Nordic welfare systems in total still offer universal coverage to citizens. The future of the systems will depend on several things, two of them being the ability to solve the unemployment problem and public support for the welfare states as a model for economic and social development. Since unemployment has been declining recently and public support remains widespread, there is no indication that the Nordic model faces neither an unemployment crisis nor a legitimacy crisis.

Entering the new millennium there is, therefore, basis for what could be called nuanced optimism concerning the future of the Nordic welfare model.

The reasons for the optimism is that the Nordic Model has been able to meet the challenge that it was faced with during the 1990s. Unemployment rates are down and there are low or no budget deficits. To use the concept of Lockwood (Lockwood, 1964) one may say that system integration has proven to be high. The political and the economic system has been able to take steps that solved the most visible problems, i.e. the unemployment problem and the fiscal problem of the State and thereby ensured the survival of the welfare model – and they have been able to do it in ways that did not jeopardize the legitimacy of the system.

The reason that the optimism is nuanced is because there is still problems facing the model. Even though the politics of the 1990s did solve some important problems new problems emerged partly as a consequence of the policy of the 1990s. To use another concept of Lockwood one may say that the positive development in employment made it even more visible than before that there are problems with social integration, i.e. the integration on the individual level. Too many people in the productive ages are being left out of the labour market and are being placed on early retirement pensions or social assistance – and the improved employment opportunities have made it clear that it is very difficult to find ways in which to integrate these into some sort of gainful employment. The efforts to try to solve this problem by the creation of a number of ‘transitional’ labour markets, i.e. types of jobs and employment arrangements where they could use whatever part of employability they possessed, still have not been very successful.

This is among other things a problem because the Nordic countries – like a number of other industrialized countries – face the problem of a fall in the number of people in productive ages and an increase in the number of pensioners. The engagement in work of at least some of the individuals on early retirement pension and social assistance can be seen as one possible contribution to try to solve this problem. Other possible solutions could be to decrease the average actual age of withdrawal from the labour market and to increase employment among immigrants. Also in these cases the Nordic model has problems.

At least in some of the Nordic countries systems for early withdrawal from the labour market were implemented during the 1980s as part of the efforts to try to solve the unemployment problem. These arrangements have become very popular and it has proven hard – close to impossible – to make changes that will ensure a higher degree of participation in the labour market among persons aged 60 or above.

When it comes to the employment of immigrants a recent OECD study (OECD, 1999) showed that the Nordic welfare states are doing really bad in this area.

When these two features of the Nordic model are combined with the fact that there is a growing wish for longer periods of vacation among individuals already employed – one could formulate what seems to be a ‘Mission impossible’ for the future of the Nordic model.

This ‘Mission impossible’ is the situation where there is an increase in the number of the elderly non-working part of the population, a wish for longer periods of vacation in the working part of the population, public support for a welfare system where benefit levels are not lowered and public support for more tax financed social services in health care and in care for the elderly – and a feeling among politicians that the very high level of taxation for several reasons can not be increased.

Perspectives: the Nordic welfare model and the service sector trilemma

There is no easy solution to these challenges but it seems obvious that one has to look at both the structure of the welfare model and the structure of the labour market to find ways in which one can address the problems.

In several studies, and most recently in Ferrera et al. (2000) the problems of the lack of private employment growth in the service sector is being highlighted as one major problem for the Nordic countries. There are many reasons for this problem, some of them being the high tax wedge that induces do-it-yourself work, the high minimum wages that hinders the creation of so-called low-

end service sector jobs and last but not least the fact that most social services are produced by the public sector.

Using Denmark as a case to illustrate the problems with and the potentials for creation of service sector jobs a survey on households latent demand for services showed that this potential was equal to the creation of 126,000 full time jobs if these services could be bought at a 'reasonable' price (Pedersen, 1995). It is not that low-end service sector jobs do not exist. A study by the Danish Social Commission showed that 200,000 students between the age of 15 and 24 were employed part-time on the labour market (Socialkommissionen, 1992), and a recent survey based on data from 1998 shows that 2/3 of the 13 to 15-year-olds have some kind of earned income (Fridberg, 1999). These figures just to indicate that under the right circumstances it is possible to have low-end service sector jobs inside the Nordic model. In the political debate on this issue low wage jobs are by some being presented as morally wrong and the situation on the US labour market is pinpointed as a deterrent example. But using the American case one can claim that not all low wage jobs are dead-end-jobs – a fraction of them are rather to be seen as job-openings for individuals with problems of otherwise getting into the labour market. One can, therefore, claim that a wage dispersion that enables that to happen can never be morally wrong – what is morally wrong – and should be avoided in the Nordic case though – is a system that creates working poor.

The case that most social services are produced by the public sector creates a somewhat different problem for the expansion of service sector employment in the Nordic countries. The problem is that a public production system reacts on political signals rather than on market signals. If an elderly person wants to buy additional services from for instance the home help provided by the municipality it is practically impossible. Instead of letting this kind of production free, politicians in the Nordic countries seem to be on a hopeless endeavour to try to fulfill the rising demands for more – and more individually oriented – social services within the public production concept.

To conclude one can, therefore, state that the future of the Nordic model is based on the ability to solve the so-called service sector trilemma – i.e. the trilemma that low wage dispersion on the labour market and budget constraints in the public sector restrict the employment growth of the service sector. The claim is that this constitutes a more viable and flexible way of increasing the

employment of marginalized groups than the so far not very successful attempts to create more or less artificial and state subsidies transitional labour markets.

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