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A Nordic Mirror: Why Structural Reform Has Proceeded Faster in Scandinavia Than in Japan

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By Richard Katz

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Abstract:

Like Japan, the countries of Scandinavia went through big macroeconomics crises brought on by structural flaws. The difference is that their recoveries came more quickly and have been far more robust. Once again, the Scandinavian economies are treated as models. We argue that three factors shed light on the difference between Japanese and Scandinavian performance:

1) Policies. We focus mainly on the strategy of "flexicurity" that provides society-wide security for workers, in return for which workers grant flexibility to business. Jobs are lost but income is sustained and a new job is found. This reduces pressure to sustain inefficient firms and industries.

2) Institutions. Centralized labor-management bargaining enhances equality, creative destruction, and responsibility. Both labor and management realize that wage hikes must be contained within the level commensurate with productivity growth and international competitiveness. Equality of wages across industries enhances market flexibility. Needed policy shifts are made easier by the fact that Scandinavia has moved from one-party dominance to contested elections.

3) Attitudes. Attitudes are born of long experience with both policies and institutions, and these attitudes, in turn, reinforce those policies and institutions. Trust is the key attitude. Workers trust they will get security if they give flexibility. Employers organized into a centralized federation treat adult training as a "public good" from which they will eventually benefit even if the particular worker that they train leaves after a few years. Voters accept harsh budget measures at a time of crisis because they trust it will be done fairly and is necessary to preserve the system.

Introduction

Japan is once again going through a sterile debate that pits growth and efficiency against equality and security.

Many leaders of the both the Liberal Democratic Party (LDP) and Democratic Party of Japan (DPJ) are misreading last July's Upper House elections as a repudiation of the reforms of former Prime Minister Junichiro Koizumi. They argue that Japan's growing income gap, falling real wages, and rising poverty rate are products of market-oriented reforms. In reality, many of these problems began years before Koizumi came to power. Nonetheless, these leaders argue that Japan must shore up equality and security by returning to the traditional growth-destroying tools of bridges to nowhere, protection of inefficient economic sectors and zombie firms, and the like. In other words, to gain equality and security, Japan must return to the practices that led to the "lost decade."

On the other hand, there are the Japanese reformers who, in the Koizumi tradition, can only see reform in the harsh "magic of the marketplace" version popularized by Ronald Reagan and Margaret Thatcher. Indeed, not so many years ago, Ichiro Ozawa praised the Thatcher model, talking as if "small government" were a panacea for Japan's myriad problems. To gain growth, Japan’s Thatcherites seem to say, the country must surrender to falling real wages and the second highest poverty rate among rich countries.

If the debate remains locked into this mode, the public will reject additional reform as too harsh. Yet, without reform and better growth, Japan's aging process would doom the people to stagnant living standards.

Moreover, the fundamental premise of the debate is misguided. Equality and growth can be allies, not alternatives. Among 12 rich countries, countries with greater income equality enjoyed *faster* growth in GDP per worker during 1995-2005 (details below). In fact, the academic literature is quite divided on how much, if any, trade-off there is between growth and equality.

Fortunately, there are other models for structural reform, some more suited to Japan's communitarian social structure and attitudes. Consider the Nordic countries: Sweden, Finland, Denmark and Norway. In their path to reform, they have followed a philosophy that the Danes call “Flexicurity,” a combination of the English words “flexibility” and “security.”

In the US, there is lots of market flexibility, but less security for workers than elsewhere. The result is good growth for the country as a whole, but stagnant living standards for typical workers. A six-month spell of unemployment or a long illness can result in the loss of one’s home. Japan and continental Europe suffer from the opposite problem: lots of security for a person at his current job, but much less flexibility for the economy. In Japan, that means mediocre growth, stagnant real wages and high levels of poverty; in continental Europe, it means mediocre growth and high unemployment.

The Scandinavians follow a third path, one that combines the growth-enhancing flexibility of the market with income security and equality for workers. Rather than trying to provide “*job security*,” i.e., protecting a worker’s ability to stay at a particular job at a particular firm for his whole career, they provide “*income and employment security*,” i.e., a society-wide social safety: generous unemployment compensation, active help in finding a new job, plus pension and health care plans not tied to any particular job. As a result, workers are willing to accept the “creative destruction” that creates economic growth. Jobs come and go. Companies come and go. But workers find new jobs, the economy’s efficiency rises, and real wages grow for just about everyone.

What makes these countries particularly interesting is their parallels with Japan. They too enjoyed rapid catch-up to the US in per capita GDP during the 1950s to early 1970s. Then, they too became fallen stars. They suffered from mounting structural flaws that finally culminated in a big macroeconomic calamity. Just as in Japan, in Sweden, Finland and Norway, it took the form of banking crises in the early 1990s. Denmark’s malaise began with a recession in the early 1980s; the problems got so bad that, in 1982, the ruling Social Democratic government threw up its arms in despair and turned the government over to the opposition without even an election. After a recovery, stagnation set in during the late 1980s when growth was limited to 0.6% from 1987 through 1993. Joblessness hit 9.5%. In Sweden, three years of negative growth—a total GDP decline of 6% during 1991-93--sent the unemployment rate from only 2% in 1988 to 9.4% by 1994. Its budget deficit soared to a stunning 13% of GDP. In a futile effort to protect its currency, Sweden raised interest rates to a Latin America-like 500%. Some of Sweden's problems were precipitated by a Depression in neighboring Finland, one its main markets. Finland's own travails were triggered by the collapse of its main market, the Soviet Union. Finnish GDP fell 13% during 1991-93 and unemployment skyrocketed to 17%.

Many analysts wrote an obituary for the Scandinavian "welfare state." Britain's Tony Blair and Germany's Gerhard Schroeder didn't even mention Scandinavia when they issued their famous "Third Way" paper in 1999.

Then, under a series of both Social Democratic and Center-Right governments, these countries instituted reforms. They cured macroeconomic instability and steadily dealt with growth-hindering structural flaws, but still maintained the traditional emphasis on equality and security. Even parties that had once preached neo-liberalism changed, realizing they had to keep the fundamentals of the Nordic model. This includes the current leaders of the ruling coalitions in Sweden and Denmark, the Moderate party and the Liberal party, respectively. They want to adjust the welfare state, not abandon it.

Successful reform has put these nations back on top. In the years since 1995, Finland and Sweden have achieved the fourth and fifth highest rates of per capita GDP growth among a group of 19 rich countries, at 3.5% and 2.7% respectively (the US came in 10th at 2.2%). Sweden and Finland came in third and fourth in productivity growth (GDP per worker). In the private sector alone, productivity growth slowly accelerated in Sweden from 2.5% in 1978-87 to 3.0% in 2002-2006. In Denmark, private sector productivity growth more than doubled from a low 1.1% to 2.5%, although there is some question as to whether that high rate can be sustained (Figure 1).

Meanwhile, flexicurity helped Denmark lower its unemployment rate to 2.9% as of October 2007, second only to Norway (2.6%) in the OECD. For some time, Sweden had suffered a “jobless recovery,” an issue that helped cause the Social Democrats to lose the 2006 election. However, in the year through November 2007, employment rose 2.7%, youth employment grew 8%, and Sweden’s unemployment rate is now down to 5.2%.

By contrast, productivity growth in the Eurozone is limping along at only 0.8%. While European unemployment has improved, it still averages 7% (about the same level as the US averaged during 1974-94). It’s above 8% in France and Germany, where employment protection laws emphasize keeping a worker in his current job rather than the ability to get a new job.

Once again, the Nordic countries are looked upon as models to be emulated. Ministers from France and Spain, officials and company chiefs from China, and labor unions from Hungary all flock to Stockholm and Copenhagen. They seek advice from Danish Employment Minister Claus Hjort Frederiksen and Sweden's former Swedish Finance Minister Par Nuder. They attend seminars run by Owe Pedersen, director of the International Center for Business and Politics in Copenhagen or Soren Andersen, a labor-management professor at the University of Copenhagen.

Today, Denmark and Sweden now stand at 3rd and 4th place as the world's most competitive economies, according to the famous ranking by the World Economic Forum. Finland is 6th and Norway 11th (caveat: the WEF ranking is a very poor predictor of growth). Then there is the "Lisbon scorecard," that ranks countries on how well they fulfill Europe's agenda for growth and competitiveness. In 2006, Denmark and Sweden came in first and second, while Finland was sixth (Norway did not participate).

In surveys on "life satisfaction," 70% of Danes say there are very satisfied, coming in first in a survey of Europe. Sweden came in fourth. There is a good reason for this satisfaction. Unlike in Japan, the improvement in the numbers for the macroeconomy did not come at the expense of ordinary people. Danish workers simultaneously enjoy the highest real wages in Europe, the second lowest unemployment rate in the OECD, and the highest income equality in the OECD. Swedes enjoyed one of the highest rates of real wage growth over the past decade. Sweden comes in second in equality; Finland and Norway are 6th and 7th.

Where Have You Gone, Joseph Schumpeter?

Joseph Schumpeter was right. In the long run, the primary source for sustained per capita GDP growth is creative destruction. It is creative destruction that promotes long-run growth in Total Factor Productivity.

It's stunning how important new firms are to productivity growth. Looking at the manufacturing sector of ten industrialized countries (unfortunately not including Japan), the OECD broke down overall productivity growth into three sources: increased productivity within existing firms; a shift in output from low-productivity incumbent firms to higher-productivity incumbent firms; and firm turnover (i.e., low-productivity firms being pushed out of business as new firms with higher productivity replaced them).[1]

What they found is this: When it comes to growth in *labor* productivity, as much as two-thirds or even three-quarters comes from the effort of each firm to improve its operations by adding new equipment and technology or shedding excess workers. This is particularly true of mature industries. Hence it is not surprising that Japan has traditionally been so good at labor productivity.

However, that route to labor productivity often came at the expense of total factor productivity (TFP). Improvements *within* each firm account for only half of TFP growth. The other half is provided by competition *among* firms. Specifically, nearly 40% of TFP growth results from newer firms displacing older firms. Both the exit of inferior firms and the entry of newer, superior firms are important. Another 13% of the total TFP growth results from efficient firms taking away market share from less efficient firms within the same industry. These figures may underestimate the role played by firm turnover and competitive pressures, since much of the improvement achieved by incumbent firms is done under the duress of competition. Superior firms pressure inferior ones to change their ways (Figure 2a)

Why is this so? In part it is because new firms more easily bring new technology, new attitudes, fresh blood. To the extent that new technologies are embedded in new capital, older firms may be reluctant to move too fast, since they have lots of sunk costs in the old capital. But the death of old, inefficient firms is equally critical. Moribund firms trap capital and labor in low-TFP-growth institutions. In the United Kingdom the exit of old moribund firms was at least as important for TFP growth as the entry of new firms, and in France the exit of old firms was dominant.

The birth and death of firms is the economy's version of Darwinian experimentation and natural selection. Most new firms do not succeed. But those that do succeed change the "economic ecology" around them.

[1] OECD 2001.

But what happens if the destruction is too destructive? What if lives shattered by the destruction are unable to find reprieve in the creation due to barriers to entry, rigid labor markets and the like? In that case, there will be a lot of resistance to destruction. There will be pressure to keep zombie firms alive. Where people depend on their current job at their current firm, there is little room for Joseph Schumpeter. The rate of entry and exit of firms will be low.

Worse yet, a number of studies of Japan in the1990s have shown that the TFP level was actually *higher* at exiting firms than at the surviving firms. It's a kind of "reverse Darwinism"—survival of the least fit. Most studies have blamed bank lending to zombies. For example, one study cites Kiyohiko Nishimura of the Cabinet Office and his colleagues thusly: "Nishimura, Nakajima, and Kiyota (2003) examined entries and exits of Japanese firms between 1994 and 1998 using METI data from the *Basic Survey of Business Structure and Activity*, and found the average productivity [*levels*] for exiting firms was often higher than the surviving firms, especially in [sectors with lots of nonperforming loans such as] construction, wholesale and retail trade. Since many exit decisions are presumably related to availability of working capital, their result indirectly suggests a misallocation of funds."[2] In this view, the preservation of zombie borrowers led to excess capacity and deflation that drove out troubled but salvageable firms, thereby lowering TFP levels and economic growth in a kind of "unnatural selection."

However, NPLs don't seem to be the entire story. In another paper, Kyoji Fukao and his colleague argue that the decline of TFP growth has been even greater in the manufacturing industry than in industries, like real estate or retail, typically thought of as the host of lots of debt-ridden zombie firms. In manufacturing as well, the TFP levels of exiting firms were higher than surviving firms. Among entering firms, the TFP levels of was higher but the rate of new entry was so low that the magnitude of positive effects was small relative to other countries. Also positive, but small, was the contribution to TFP made by superior firms seizing market share. In addition, a great deal of the entry and exit came from incumbent firms switching industries rather than new firms being born and old ones dying. So, in Japan, most of the TFP growth came from incumbent

[2] Cited in Hoshi and Kashyup (2004). It should be noted that, in another paper, Nishimura noted that TFP *growth rates* tended to be lower in exiting firms (Nishimura 2005).

firms improving their performance. In this regard, say the authors, Japan was an outlier compared to other rich countries (Figure 2b).[3]

As with other studies, these authors conclude that a dysfunctional financial system is at least one of the causes: "The above result suggests that in order to accelerate TFP growth in Japan's manufacturing sector it is important to promote new entries and to make both the exit process and the process of resource allocation more efficient…Using regression analysis based on pooled cross-industry data, Fukao and Kwon (2003) found that there is a significant negative correlation between the exit effect and that industry's average liability-asset ratio. That is, in industries [i.e. one of 58 sub-industries within the manufacturing—rk] where the liability-asset ratio is high, the exit effect tends to be negative. There is a possibility that the malfunction of Japan's financial system contributes to the negative exit effect by allowing zombie firms to survive while high-productive small firms fail as a result of a credit crunch."[4]

What we don't know is whether this pattern of "reversed Darwinism" existed prior to the 1990s or whether it persists into the current decade. Undoubtedly, preservation of outright zombies has been reduced. What we do know is that barriers to the exit of old firms are a barrier to the entry of new ones. Historically, firm turnover in Japan (and hence job turnover) has been very low by international standards (Figure 3a). We also know that, at least though 2002, it's hard to see a secular improvement in that pattern. Exit is a bit higher than at the end of the bubble, though still lower than in pre-bubble days. Entry, by at least one measure, was at a record low rate as of 2002. Presumably, the post-2002 recovery has improved the rate of entry (Figure 3b). We don't know what it has done to the rate of exit. By contrast, Denmark has one of the highest rates of firm turnover in Europe. Sweden one of the lowest rates in Europe, but it's still about twice the rate of Japan (Figure 3c).

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[3] Fukao and Kwon (2005). In the US, it is more likely that a new technology will be introduced via a new firm, e.g. Intel and Microsoft displacing IBM. In Japan (and in Sweden but not Denmark), it is more likely that an incumbent firm will develop a new division or affiliate devoted to the new technology. We are not saying that one model is inherently better than the other. Our concern is the impact of the company-centered security on protection of inferior firms and labor market rigidity. For a contrary view that the American model is the single best route to growth, see Baumol et. al. (2007).

[4] Fukao and Kwon (2005). For this cross-industry regression, Fukao and Kwon (2003) divide the manufacturing firm data into 58 sets of different industries and estimated the "exit effect" in each industry.

Then there is the all-important ability of new firms to grow. Here is where the US firm-creating machine really stands out. After two years, the average new firm in the US has increased employment by 160%, much more so than in Europe. Within Europe, Finland has a high rate; Sweden and Denmark have middling rates. Unfortunately, we don't have the data for Japan (Figure 3d).

There is an additional problem in Japan. While there is lots of competition in Japan's efficient export-oriented industries (as measured by change in market ranking, market share, and entry of new firms into the ranks of industry leaders), many of Japan's domestically-oriented sectors exhibit signs of mutual non-aggression pacts with little change in ranking (Figure 4). Michael Porter and his colleagues have shown that the best predictor of firm performance in Japan (unfortunately measured only in export performance) is not scale, but the fierceness of domestic competition.[5] The dearth of competition is probably one reason why Fukao and Kwon found so little TFP benefit from superior firms taking market share from inferior ones—even in manufacturing. In the effort to preserve stability, Japan has sacrificed efficiency.

No one would doubt that there has been lots of reform in Japan in the last decade. What we do doubt is that is has been widespread enough, or achieved enough critical mass, or has had a long enough gestation period to engender a productivity revolution. While measured productivity growth has indeed improved, most of this is simply due to the effect of the business cycle on the figures. Year-on-year productivity growth goes up and down with GDP growth. Looking at the aggregate economy, it's hard to see much of acceleration in trend productivity growth (Figure 5a). And, if we break down the productivity growth by sector, except for a very encouraging improvement in distribution—the subject of major reform--we see most of the improvement in the same few sectors that have always worked hard on improving themselves (Figure 5b). Japan is getting the most reform where it needs it least and the least reform where it needs it most.

While many analysts point to the financial system, we believe the functioning of the financial system reflects a deeper underlying part of Japan's political economy. After all, why would banks want to lend to the less creditworthy unless there is something else going on? That "something else," we believe, is Japan's rigid labor market. It is one key

[5] Porter et. al. (2000).

reason for the slow pace of creative destruction. In Japan, the real social safety net is one's job at the current firm. Big companies practice "internal flexibility, i.e. keeping the worker employed but changing hours, cutting wages and/or bonuses, transferring workers to affiliated firms, and so forth. Lateral job mobility is hard since firms resist "poaching" on each other. Court decisions and prevailing mores have made mass layoffs difficult.[6] Moreover, workers have lots of incentives to stick with the same employer. Seniority wages are as strong as ever (Figure 6). The unemployment and pension systems are also tied to job tenure (details below). Moreover, to avoid mass layoffs, the government subsidizes at least some firms to keep workers on the job during bad times.[7]

While we don't doubt that lifetime employment and internal flexibility provided real strengths to Japan in a time of solid growth—both economic and demographic—we believe that, in the current era, its costs are greater than its benefits. Some people speak of the breakdown in lifetime employment and an increase in "flexibility." However, what we believe is going on is a bifurcation of the labor force. Core workers have all of the traditional safeguards at their firm, while a growing portion of the labor force—now said to number a third—are irregular part-time and temporary workers with much fewer protections and benefits, as well as much lower hourly wages. Depending on their conditions of work, e.g. how many hours per week, many of these irregular workers lack both full access to the internal safety nets regarding health care, unemployment insurance and pensions of regular workers, and they also lack sufficient society-wide safety nets because the latter are so thin for irregular workers. The unions seem to accept lower standards for irregular workers, because they see that as a way of keeping the company around as the employer of their core members. Thus, in this regard, the company-based unions have more solidarity with their employer than with their fellow workers.

Our conclusion is that inferior companies are preserved because that's the way to

[6] 1979 case law established four conditions to be met before *regular employees* could be dismissed: (1) employers should be faced with compelling and unavoidable necessity for dismissals; (2) they should have made every effort to avoid dismissals (e.g. transfers to affiliated companies, terminating employment of temporary and part-time workers, facilitating early retirement, reducing overtime and suspending new hires); (3) they should consult with trade union representatives and employees about dismissals; and (4) they should establish reasonable standards and apply them fairly when selecting workers for dismissal.

[7] Bredgaard and Larsen (2007) write: "Since 1975, the employment adjustment subsidy has played a central role in Japan’s employment policy…[w]hen enterprises in designated industries strive to maintain employment during a downturn."

preserve the social safety net for the core lifetime employees.[8]

Three Models of Capitalism

The literature on "varieties of capitalism" tends to speak of two models of capitalism: the liberal market economies characteristic of Anglo-America and the coordinated market economies characteristic of Japan and Europe. However, for the purposes of this paper, it is more helpful to think of three models: the Japan model (some of whose characteristics are shared by continental Europe), the US model and the Swedish model.

Swedish model: Income distribution produced by the market (wages, income of self-employed, and returns to capital) is unequal. However, government redistribution (taxes and transfer payments) do a great deal not only to make income distribution more equal but also to provide a *society-wide* safety net in case of job loss or ill health.

American model (particularly post-Reagan): Income distribution produced by the market is unequal and government redistribution only modifies this a little. The labor market is very flexible, but there is much less social protection in case of unemployment or a health care crisis, or aging.

Japan model (particularly pre-1990 or 1995): Income distribution apparently produced by the market is more equal than elsewhere; hence the government does little directly to redistribute income. The labor market is less flexible and the society-wide social safety net is so thin that workers are much more dependent on their particular job as the main safety net.

We will get into the security issues later. For now, let's focus on equality.

[8] Bredgaard and Larsen (2007) write: "At its extreme, the proportion of lifetime workers among male university graduates in large firms is 55%... In a study of separation rates during the lost decade, Kato finds little evidence for serious erosion of the practice of life-time employment…Rather than dismissing workers, large firms…[are] relying on transfers…and … cutting on new recruits."

First, let's look at the distribution of income produced by the market in 1995 (top panel of Table 1a). Among the 12 countries in this OECD survey, Japan had, by far, the highest share for the poorest 30% and the lowest share for the richest 30%. The US and Sweden look surprisingly like each other.

Now, let's look at the final disposable income after including taxes and transfer payments (middle panel of Table 1). Sweden, along with Denmark, had the highest share of disposable income going to the poor and lowest share to the richest 30%. Japan was very close to the 12 country average. The US had the lowest share going to the poor and tied with Italy for the most going to the rich.

Finally, let's look at the impact of government in redistributing income (bottom panel). Denmark and Sweden, along with Belgium, did the most to shift income from rich to poor. Japan, by far, did the least. The US was second to Japan in doing so little. In most countries, by far the lion's share of redistribution is to the poor. However, in Japan and the US, a far larger share of the (small) redistribution goes to the middle class.

Table 1b covers just the working age population for the year 2000 and gives somewhat different results. Japan appears less egalitarian in these results, with the post-government share of the poorest 30% less than the OECD average. Also, note that, among working age people, Sweden, Denmark and Finland do a lot of redistribution to the middle class as well as the poor. The US redistributes more to the middle class than the poor and almost all of Japan's redistribution is to the middle class. (Table 1b is from a different series and may not be strictly commensurate with Table 1a)

Interestingly enough, during the mid-1980s, Norway and Denmark looked more like Japan if we use a different measure of income equality: the Gini coefficient for working age households (Table 2). Among 15 OECD countries, Norway and Denmark topped the ranks with the most equal market-determined distribution of income. Japan came in fourth. As a result, like Japan, Denmark and Norway saw little need to do that much via taxes and government transfer payments. Denmark ranked 13th and Norway ranked 11th in government measures to equalize income. Japan was 15th. Nonetheless, because market-determined income distribution had started off so equally, Denmark came in 2nd and Norway 3rd in the final post-government distribution of disposable income. Japan didn’t do so well: only 9th. The US, by the way, came in 10th in the pre-governmental Gini, dead last among the 15 in the impact of governmental measures, and dead last in post-governmental equality.

However, by the year 2000, Denmark (but not Norway) had shifted to a somewhat greater role for government. It came in second in pre-governmental equality, first in post-governmental equality, and third in the impact of governmental measures. In 2000, Japan was third in pre-governmental equality, 10th in post-governmental equality and last in the impact of governmental measures.

One of the reasons for the greater equality in Scandinavia is that they ensure equality, not just across income classes, but during the life cycle. A generous society-wide social safety net ensures that a spell of joblessness or a health care crisis does not cause someone to lose their home or enter poverty. Social insurance buffers equality.

Although there has been a trend toward greater inequality throughout the OECD in the last couple decades, a trend to which Scandinavia has not been immune, the Scandinavians have not given up very much equality in their drive toward greater efficiency (Figure 7).

Japan's people have been accustomed to an economy in which equality appears to have been produced by the market. Now, due to a combination of economic malaise, market-oriented reforms, and the corporate world’s turn toward irregular workers, that market-income equality is eroding. Japan is, in effect, moving from the classic Japan model closer to the US model. What would serve it better, in our view, is to move toward something closer to the Swedish model.

Almost all OECD countries have moved to a less egalitarian distribution of market-based income among working age people. In fact, the more egalitarian the distribution was the mid-1980s, the greater the shift toward less equality. The Scandinavians were hardly immune to this shift. Japan's shift was somewhat less than the normal as indicated by the trend line (Figure 8a). On the other hand, the countries experiencing the greatest shift toward market inequality did the most to make up for this shift via government remedies. Sweden and Denmark did somewhat more than the typical country, while Japan did somewhat less (Figure 8b). The overall result is that, in general, the countries with the most egalitarian distribution in disposable income in the mid-1980s also had the most egalitarian distribution in 2000 (Figure 8c).

What is overlooked by Japan's Thatcherite reformers and “the resistance forces” alike is that market-produced income equality can be done either in ways that aid growth or hinder it. It's one thing to produce equality via the *shunto* and equality of educational opportunities. It's quite another to produce it via bridges to nowhere, price supports for farmers, and saving zombie firms. Japan’s company-centered path to security and equality not only helped lead to the “lost decade," but has also slowed the structural reforms needed to fully recover from it. By contrast, Scandinavia’s society-centered path to security and equality has led to rapid recovery from their crisis.

Equality and Growth

“A bumble bee that flies.” That’s how former Swedish Social Democratic Finance Minister Par Nuder describes the success of the Scandinavian model.[9] By the laws of physics as now understood, the bumblebee should not be able to fly. Yet, it does. Similarly, many neoliberal economists and politicians say that economies marked by high tax rates, “overly” generous unemployment insurance systems, and “excessive” income equality should not fly either. Yet, fly they do.

Some economists claim equality comes at the expense of growth. *Equality and Efficiency: The Big Tradeoff*, a very influential 1975 book by Arthur Okun, formerly a top economic adviser to Presidents John Kennedy and Lyndon Johnson, set the tone for this type of thinking. Today, however, the academic journals are filled with papers arguing both sides of the question. One of the most interesting explorations of the issue is Jonas Pontusson's 2005 book, *Inequality and Prosperity*, which also adopts the three-model approach and finds no trade-off between equality and growth.

We don't want to attempt a full exploration of the issue. But a cursory look at the data does not show any obvious link between equality and growth in either direction. What we suspect is that the real issue is not equality versus inequality, but how that equality is produced. Is it done in growth-harmonious ways or growing hindering ways?

In the top panel of Figure 9, countries with greater income equality enjoyed

[9] Interview with author, December 2007

somewhat higher per capita growth during the last decade. However, the R-squared is tiny. Thus, all we can say is that, from this small sample during these years, there is no evidence of a growth-equality trade-off. In the bottom panel, we look at the size of governmental redistribution measures. Again, countries that did more redistribution enjoyed better growth but the result does not pass muster on statistical significance.

What this suggests is that countries have a political choice on equality. They do not necessarily have to give up equality to gain efficiency. Or, at least, the trade-offs may be a lot smaller than under the choices now being presented to the Japanese voter.

Culture vs. History

Japan has more in common with the Nordic countries than the fact that Norway also hunts whales while safeguarding farmers. Like Japan, the Nordic countries were horribly poor a century ago, when a famous writer called Sweden “a fortified poorhouse.” And, like Japan, Nordic countries now seen as epitomizing social harmony, were once homes to terrible internal violence, from labor-management clashes in Sweden and Denmark to outright civil war in Finland.

The modern Scandinavian welfare state springs not from ancient culture but from recent history. There were some early attempts at compromise, including an 1899 labor-employer pact in Denmark, those failed to prevent outbreaks of violence and big strikes). The great turning point came in 1929-1932 when Social Democrats successively took power in Denmark, Sweden, and Norway. Epitomized by the famous Saltsjobaden Agreement of 1938 between Swedish trade union federation (LO) and employers' federation (SAF), the grand historical labor-business compromise laid the foundations for growth, social harmony and consensus decision-making, and modern welfare state.[10]

It also laid the basis for decades of virtually uninterrupted dominance by the Social Democrats (by themselves in Sweden and as the leader of coalition governments in Denmark). As in Japan, single-party dominance eventually led to excesses, rigidity, and economic malaise. In 1976 in Sweden and 1982 in Denmark, the Social Democrats

[10] For a general review, see Einhorn and Logue.

fell from power. Since then, parties have alternated in power. The experience of both victory and defeat has led the Social Democrats to moderate their vision and the Liberals in Denmark and the Moderates in Sweden (who now lead multi-party center-right coalition governments) to abandon neo-liberalism.

We believe the transition from one-party democracy to genuine party competition has a lot to do with the ability of these societies to make the adjustments necessary for successful reform.

Flexicurity and The Three-Legged Stool

What makes the system work is what people sometimes call a "golden triangle," but what could also be described as a three-legged stool that topples unless all three legs are strong. The three legs are:

1) macroeconomic stability;
2) a flexible, globalized market-oriented business/labor system that promotes growth; and
3) income equality and security.

Keeping inflation low means workers don't need to seek excessive *nominal* wage hikes that price exports—about half of GDP—out of the market. Stable inflation and budget balances avoid stop-go macroeconomic policies. Conversely, an active labor market policy that quickly retrains and reemploys laid-off workers keeps structural unemployment low. In a December 2007 interview with the author, Danish finance ministry officials said that they estimate that Denmark has lowered NAIRU from 9% to 4.5% over the past ten years. Hence, there is no political demand for the excessive monetary or fiscal stimulus that results in inflation. Conversely, there is no demand for the disinflationary monetary policies that kept US unemployment at a 7% average from 1977 through 1994.[11] Administratively expensive microeconomic measures were used to

[11] And might have kept unemployment at a high level even longer had Alan Greenspan not taken a chance on growth.

achieve results attained via administratively cheaper but socially more costly macroeconomic instruments elsewhere. Meanwhile, good growth, efficiency and some of the highest employment rates among rich countries all provide the means to finance the welfare state's famous social benefits—from generous unemployment compensation, to free child care, elderly care, health care and education. In turn, those expensive social benefits—paid for by taxes and spending that take up almost half of GDP-- make workers unafraid of the "creative destruction" that promotes growth and efficiency.

It is the latter point which is most important for the cause of reform in Japan—and for the US as well. The social security benefits that some neoliberal economists claim will destroy efficiency and growth can do the opposite—as long they are done correctly.

Unlike Japan or much of continental Europe, Scandinavian welfare states do not attempt to protect a worker's particular job in a particular firm. It is cheaper and easier to layoff redundant workers or even close down a plant in Scandinavia than in Germany or France. Workers lose jobs as companies downsize and, especially in Denmark, can be fired because of incompetence. 30% of Danes change jobs every year, the highest in the OECD. What is protected is a worker's income while he or she is unemployed, through generous unemployment insurance that replaces up to 75-90% of a low-income worker's wage, and "active labor market programs" that help workers to get a new job quickly. The Scandinavians talk, not of job security, but of employment security.[12]

Every year, 11% of Danes lose their jobs and another 20% quit to find better jobs. So, altogether nearly a third of all Danes switch jobs every year, the highest turnover rate in the OECD (Figure 10). Job tenure is much higher in Sweden, partly due to "first in, last out" layoff policies. Nonetheless, flexibility is still high in Sweden.

For those who are laid off, Denmark provides the most generous unemployment insurance in the OECD (Figure 11 and Table 3). A Swedish or Danish worker earning 75% of the income of an average production worker gets enough unemployment compensation to replace about 75-80% of his lost income—compared to only 26% in

[12] Political objectives may lie behind the difference between job security and employment security. In Scandinavia, it was the labor movement that chose the objective of society-wide employment security in the interests of equality and social insurance. Pontusson (2005) notes that, in continental Europe, it was the conservatives who proposed job security tie to the firm as a method of social stability. This paternalism not only competed against the socialists, but also gave the worker a greater shared interest with his employer than with fellow workers at a competing firm or in another industry. For Japan, see Gordon (1998).

Britain, and 60% in Germany. The average worker in Scandinavia gets about 60% versus a third in the US. Moreover, 20% of Americans job-losers find they are ineligible for unemployment benefits.[13]

By contrast, the Japanese system is calculated to provide incentives for both firms and employees to practice long tenure at the same firm.

According to one study, despite higher statutory rates for unemployment, the actual effective replacement rate for a typical unemployed worker in Japan is a shockingly low 10%, compared to an OECD-wide average of 30% (Figure 12). One reason would seem to be that benefits run out for the long-term unemployed for reasons to be discussed immediately below. Secondly, "the Japanese unemployment insurance system has extremely strict conditions for eligibility, which is indicated by the fact that the ratio of benefit receipt to total unemployed was only around one-third at the end of the 1990s."[14]

It is not just low replacement rates that compel workers in Japan to rely on job security at their current firm rather than employment security within the economy as whole. It is the fact that, like seniority wages, the unemployment system is structured to reward those who stay longer on their job. A worker under age 44 whose has done insured work for as long as five years can only get unemployment benefits for 90 days, whereas a 45-59 year-old who has done insured work for 20 years is eligible for 300 days worth of benefits (Table 4). While insured work does not necessarily mean working at the same firm, this provision, in combination with the dearth of lateral occupational mobility, means that short-tenured workers who lose a job are in big danger of seeing their benefits run out. That's because long-term unemployment is fairly high in Japan: Around 50% of Japanese unemployed experience unemployment for more than 6 months, and around 33% for more than 12 months. The corresponding figures for Denmark were also high at 44% and 26% respectively, which put a lot of financial pressure on Denmark to lower overall unemployment.[15]

Japan's system also punishes the growing ranks of part-time and temporary workers since eligibility is limited to those who have worked more than 20 hours a week

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[13] Ilsoe (2007).
[14] Bredgaard and Larsen (2007).
[15] Bredgaard and Larsen (2007).

and have done insured work for six of the previous twelve months.

Japan's pension system also penalizes workers who leave, or get dismissed from, their firm. Japanese enterprises finance the retirement pension system of their workers in proportion to the number of years of service at a specific company and depending on the reason for retirement, i.e. voluntary versus mandatory or company requested retirement.

No wonder that in Japan, as in continental Europe, nearly half of all workers have worked at the same firm for more than 10 years (Table 5). The comparable figures are 26% in the US and 31% in Denmark.

To motivate long-term unemployed to look harder for jobs, both Denmark and Sweden have somewhat tightened their benefits. In 1994, Denmark significantly shifted from just passive unemployment benefits to a more active labor market policy. As part of the shift, the trade unions accepted a decrease in the period of eligibility for unemployment benefits, as well as a worker's right to regain eligibility simply by participating in activation measures rather than holding an actual job. Denmark has cut the duration of unemployment compensation to a still very generous four years and may cut it further. For a low-income worker in Sweden, the amount of income replaced now declines from an initial 80% to 70% after 40 weeks, and then 65% after 60 weeks. According to one study, the typical replacement level in Denmark has fallen back from 65% in the mid-1990s to 50% these days (see again Figure 11).

Meanwhile, in both Sweden and Denmark, *center-right* coalitions are cutting taxes for *low-income* workers, through earned income tax credits as well as cuts in tax rates. The purpose is to widen the gap between the unemployment benefit and after-tax income, so as to give low-skill workers more incentive to find work. Denmark also provides employers with temporary subsidies to hire long unemployed, low-skill workers. Strict rules prevent these subsidized workers from undercutting regular workers.

What really makes Denmark and Sweden stand out are their "active labor market programs." They each spend 1.5% of GDP a year on these programs, more than any other rich country besides Holland, which was the first country to introduce a "flexicurity" system (Figure 13). At any given time, about 30-40% of Danish unemployed are in programs ranging from subsidized training programs at the technical schools or companies, to subsidies for "Flexjobs," to re-training programs for workers who can no longer find new jobs in their old occupation, to temporary subsidies for firms to hire long unemployed low-skill workers. Once again, strict rules prevent these subsidized workers from undercutting regular workers.

Jette Sindholt is one of the faces of Flexicurity in Denmark. After working 12 years running a cigarette-making machine at the House of Prince (HOP), Jette fell severely ill three years ago. She had to stay home for three full months. Worse yet, she never fully recovered. Elsewhere, this might have spelled disaster. But not in Denmark. The government not only paid for her health care but it also gave her a sick leave payment during her illness. Then, HOP took her back in a "Flexjob." Unable to work either full-time or to operate the machinery, she instead, she works five hours a day in quality control. HOP still pays her the full salary of a machine operator, and half of that money comes from the government. This outcome makes everyone happy. "I'd much rather be working than sitting at home," says Jette. The taxpayers are better off because, if Jette had not returned to work, she'd be entitled to a government-paid disability pension. While less than what she now earns, it would be more the Flexjob subsidy the government now provides. Finally, HOP has retained a loyal, conscientious worker. Although Jette needs extra rest breaks, the government subsidy makes it worthwhile to HOP. Not all workers in Jette's situation are quite as fortunate as she is. "HOP is an exceptional company. Some other company might have let me go." But most workers in Jette's situation are a lot better off than in other rich countries.[16]

Other faces of Danish Flexicurity include the already-employed machinery operators that HOP sends to a two-year technical training school to upgrade their skills. The government pays for the school while HOP pays the workers' salary. In return, HOP gets workers who have learned how to fix the machinery and even improve it.

At any given time, 30% of Danish and Swedish adults are in some sort of government-financed adult education and training program, the highest ratios in the OECD (Figure 14). Flexicurity is a kind of *kaizen* for both people and the production process.

Then there are the workers from government-financed technical schools that HOP accepts for three months of on-the-job training. Some of these are job-losers who need

[16] Interview with author in December 2007.

training for a new occupation. Some of them are people who just wanted to better themselves. HOP won't get a permanent benefit since it has few new openings to hire these trainees. Why then does HOP do it? "It's our social responsibility," says production manager Christian Johansen.[17] Taking on these trainees does impose some cost to HOP; so here, too, the government provides a subsidy.

Some low-skill workers, particularly those out of work for some time, are less motivated than the majority of jobless. Most of the workers who come to firms directly out of these training programs are taken up a minimum wages by firms like big cleaning services. Sometimes, the people who answer the ads are graduates of the government's training programs. However, says production chief Johansen, when a worker waits until he is sent by the program itself, he is often less interested in the job than in being able to show that he has gone on the interview so he can keep his unemployment benefits.

Combining active labor measures and unemployment compensation, Denmark spent 4.2% of GDP and Sweden 2.5% in 2005, numbers that have come down as unemployment has been rolled back (see again Figure 12).

Most of this money is well spent. Not only did Denmark reduce unemployment from nearly 10% in 1993 to less than 3% today, but only 0.8% of workers have been out of work for more than 12 months. In Sweden it's 1%.

Not surprisingly, when people were asked if they felt anxious about losing their current job, Danes, Swedes and Finns were among the least fearful in Europe (Figure 15). In fact, 80% of Swedes and 75% of Danes say they benefit from switching jobs, compared to only 40% in the rest of the EU.

Whatever their other differences, there is clear agreement between labor and the Social Democrats on the one hand and business and the center and right parties on the other hand on the basic nature of the social contract: "flexicurity," i.e. market flexibility in return for employment and income security. The fights are not over whether to do this, but how. One area of disagreement is how to employ the more marginal workers among those with low levels of education, immigrants, and forth.

However, when it comes to the basic "flexicurity" social contract, labor and business agree. A joint document by the Danish Confederation of Trade Unions (LO) and

[17] Interview with author in December 2007.

the Confederation of Employers (DA) describes the labor-management bargain this way: “It is almost costless for workers to change jobs as they do not loose any rights like paid holidays, pensions etc. and for companies it is relatively easy to dismiss an employee.”[18]

When asked about Japan's or continental Europe's attempt to protect particular jobs at particular companies, Nuder, the Social Democrat responded, "Our tradition is that we protect people, but not jobs. Being a small country, depending on exports, we can't even think of trying to protect our industry. We have to be very competitive. This means that we have to be very pro-change." The secret, he says, is that, "We have created social bridges for people to walk on from old conditions that are no longer competitive jobs to new conditions. If you want to have a strong capitalism, you have to have a strong social safety net."[19]

His words are almost the same as those spoken by his political opponent, current Danish Prime Minister Anders Fogh Rasmussen, a man who used to be a neoliberal. Back in 2004 at a congress of his Liberal party, Rasmussen declared, “By international standards, we have a very flexible labor market…It is easy for Danish employers to hire and fire employees.” But, then he added, “This is, however, only possible because we have a high level of social security.”[20] And that social security, in turn, is only possible because of high level of taxes and spending.

Swedish State Secretary of Finance Hans Lindblad, one of three politically-appointed State Secretaries serving directly under the Finance Minister, explained it this way: "Just as you buy insurance to spread risk, here we spread the risk to everyone through a publicly-funded social welfare system. In Japan it is kept within the company, which we think is more risky."[21]

By contrast, in Japan and continental Europe, well-meaning laws and practices protecting workers in their current jobs often hurt the very people they aim to help. Firms that are restricted from getting rid of excess workers in tough times are extra careful about hiring them even in good times. In Japan, that leads to protecting zombie firms and to firms switching to low-wage irregular workers, who now comprise a third of the labor

[18] Jensen and Larsen.
[19] December 2007 interview with author.
[20] Bredgaard and Larsen (2007)
[21] December 2007 interview with author.

force. In continental Europe, that leads to high long-term unemployment and high youth unemployment. The long-term (over 12 month) unemployment rate is 4% in France and 5% in Germany.

What it also leads to in Japan is overworked. Rather than hire a new employee—which implies an increase in fixed costs and commitments—firms would rather have the existing employees work longer hours. The proportion of Japanese workers working more than 50 hours a week in year 2002 was 28% compared to 20% in the United States, 15% in the United Kingdom, 5% in Denmark, and 1.4% in the Netherlands. The proportion of Japanese workers working more than 60 hours per week was 12% in 2004. Despite this—or because of this--the premium pay for overtime work was low in Japan compared to other countries.[22]

The US suffers the opposite problem from Japan and continental Europe. Labor markets are very flexible but at the cost of real wages. American workers losing their jobs due to imports face an average 20% pay cut at their new job (Figure 16). No wonder that there is a growing backlash against globalization in the US among both Democratic and Republican voters. By contrast, when a worker in Denmark or Sweden loses his job, be it from imports, technology or some other cause, he is much more likely to get a new job at an equivalent wage—and perhaps higher if his skills have been upgraded.

Workers unafraid to lose their jobs make no political demands to keep “zombie” firms or industries alive. Nor do workers need fear that globalization will take their livelihoods away. On the contrary, in Sweden, 80% tell pollsters that increased trade is a good thing for their country. In Denmark, Minister for Employment Claus Hjort Frederiksen says that 70% of Danes regard globalization as "a unique economic opportunity." In the rest of Europe, he says, the figure is only 40%.[23]

Lena Westerlund, senior international economist at The Swedish Trade Union Confederation, declared, "We are pro-free trade. Sweden would not have been at this level of per capita income we didn't have an open economy. But we want to have security for the workers." Whether globalization is positive or negative for workers, Westerlund cautioned, depends on the strength of institutions that support security and equality.

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[22] Bredgaard and Larsen (2007)
[23] December 2007 interview with author.

Given the lack of security in the US, she says it is rational for American workers to fear globalization.[24]

The result of the Scandinavian grand bargain on flexicurity is a system that allows firms and workers to easily shift from sunset companies and industries into sunrise ones. That, as we shall see, sparked a renewed spurt of growth and productivity after the reforms of the 1990s.

Some critics of the system, including many voters, say that, in Sweden at least, the system has failed to create enough new jobs, particularly in the private sector. It's one of the reasons that the Swedish Social Democrats lost the election in 2006 after spending 12 years presiding over the recovery. Booming GDP growth failed to translate into new *private sector* jobs.

The truth is a bit more complicated. For one thing, in 2005, Denmark, Norway and Sweden had the second, third and fifth highest employment rates among 22 countries in the OECD (Figure 17). Secondly, over the past 20 years, the best predictor of job growth has been demographics: growth in the working age population (Figure 18a). Finally, there has been somewhat of a regression to the mean on employment rates. Countries with the highest employment rates, like Sweden and Denmark, did the worst at creating new jobs, while countries with low employment rates like Holland and Ireland did much better (Figure 18b).

Nonetheless, the failure of the system to create enough new private sector jobs is a big political issue, and one that divides the parties. But debates about solutions take place within the context of the flexicurity philosophy, not as part of an effort to overthrow it. And this year may be the beginning of progress on that front. In the year through November 2007, jobs grew by 2.7% from November 2006. Employment growth among young people -- the 15-24 year olds -- was particularly marked, increasing 8.4%

Scandinavia also holds important lessons for those who call globalization a “race to the bottom” that drives down wages. During the past decade, Sweden topped the charts in real wage growth, while still having one of the highest trade:GDP ratios in the OECD. Norway came in second in wage growth (Figure 19).

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[24] December 2007 interview with author.

Wage Equality Can Promote Productivity

One of the most famous aspects of Scandinavia's "bumblebee economics" is a wage system promoting the highest income equality in the OECD. Some economists claim this equality must come at the expense of growth. The reality on the ground seems to show that, when done correctly, equality-promoting measures can also be growth-promoting.

As part of an historical compromise beginning in Sweden in the late 1930s, the Scandinavian countries adopted a policy of ensuring more or less equal pay for equal work. In many countries, janitors working for computer companies get higher wages than janitors working for apparel manufacturers. So do accountants and assembly line workers. In Scandinavia, he big trade union federations and the employers associations got together and set the pace for a fairly uniform rate of wage increase. From the 1960s through the 1980s, wage inequality among Swedish blue-collar workers decreased by a stunning 75%.[25] Although the mechanisms and levels of formal centralization have changed over time, the principle of fairly equal wages remains at the core of the Scandinavian model.

The cross-country data seems to show: the more centralized the bargaining, the greater the wage equality (Figure 20). In Japan, as the *shunto* weakened, the wage premium of workers in the 6,000 biggest firms increased. In the mid-1970s, workers in big firms earned 53% more than their small firm counterparts; today it's over 90% (Figure 21).

Back in the 1940s, two economists from Swedish Trade Union Confederation, Gösta Rehn and Rudolf Meidner, argued that wage equality for people in the same occupation would help promote productivity growth. Low wages, they argued, were a subsidy to inefficient firms and industries. Conversely, making wages more equal would help efficient firms and industries make higher profits, which they could use to expand and thus become a larger share of the economy. Inefficient industries and firms would either have to improve or downsize, perhaps even close down. Gradually, in a kind of

[25] Hibbs and Locking. "The Swedish wage premia exhibit no systematic relation to average productivity (or profitability), whereas in the United States an inter-industry rent-sharing pattern is pronounced. This evidence suggests that Phase I centralized solidarity bargaining may have helped create a national wage market more closely corresponding to the neoclassical competitive model than the pattern that seems to arise in decentralized wage formation systems, with or without the presence of trade unions."

Darwinian selection process, capital and labor and output would seamlessly shift toward more efficient industries and firms.

The system worked. According to a 2000 study by economists Douglas Hibbs and Hakan Locking, “Equalization of relative wages between plants and industries evidently raised aggregate output and productivity significantly, most likely…by expediting the flow of labor and capital resources from less to more efficient activities.”[26] Efficiency plus equality means higher real wages for everyone.

But then the Social Democrats and unions went too far. They didn’t just want janitors and machine tool workers to earn the same regardless of industry; they wanted to erase too much of the pay difference between janitors and machine tool workers and doctors. From “equal pay for equal work,” they, in effect, shifted to “equal pay for all work... This, argued Hibbs and Locking, hurt productivity and economic growth, partly because it eroded incentives for people to better themselves.

The problems caused by this shift ended up leading both the Swedish Employers Federation (SAF) and the union of workers in the machinery industry, Metall, to break with the central bargaining system in various ways during the 1980s to early 1990s. In 1990-91, in the midst of the economic crisis, SAF formally broke with the whole model of centralized bargaining. In fact, under the slogan, "farewell to corporatism," for a while the SAF tried to take the neoliberal approach of ending the Swedish welfare state.

However, the 1990 break was more complicated than a simple issue of capital versus labor, or neoliberal thinking among the employers. Torben Iversen, in fact, argues the opposite: that it was caused by a "cross-class coalition" of labor and capital in the engineering industries exposed to international competition versus the sheltered public sector workers. Skilled workers in the engineering sectors wanted higher wages—and employers were willing to pay higher wages to attract better workers. But neither the IG Metall union nor the employers in those industries wanted higher wages in the export sector to lead to commensurate higher wages among public workers, which would mean higher taxes. A similar process occurred in Denmark.[27]

In the end, both Sweden and Denmark ended up reconstituting coordinated wage

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[26] Ibid.
[27] Iversen

bargaining system in a more complex form. One reason that, in Sweden as elsewhere, centralized bargaining in a small country leads both labor and management to think more in terms of the impact of their actions on the country as a whole. Workers, particularly those in export sectors, are more likely to moderate their nominal demands under centralized bargaining than under decentralized. Lena Westerlund of the Swedish union federations argues that this has ended up benefiting the workers themselves: while they bargained for nominal wage hikes in the inflationary 1980s, which fueled both inflation and currency depreciation, they did much better in real terms once inflation was tamed.[28]

Anti-Poverty and Social Mobility

Social mobility, the ability of poor but talented children to rise, is a prime ingredient of growth. It's one reason that America has always thought of itself as the land of opportunity. It's one reason that, after World War II, the US government spent lots of money helping poor and middle class students go to college. Today, in the post-Reagan era, that ethic no longer prevails. Social mobility is a lot lower in the US than in Scandinavia.

In the US, analysts often speak of a cycle of poverty: single mothers bearing children who grow up in poverty, ill health, lack of education, crime-ridden neighborhoods. All this leads the children of the poor to have a tougher time doing well in school and escaping poverty.

Scandinavia spends a lot of money to reduce poverty, defined as disposable income less than one-half of the median household disposable income (median is where half of households have more and half have less). Just 5% of Swedes and Danes live in poverty, the second and third lowest among a group of 17 OECD countries. By contrast, Japan at 13.5% and the US at 13.7% have the highest poverty rates in the OECD. Interestingly, all four of these countries start off with similar rates of poverty, as determined in the market. The difference is that the Danes and Swedes lift most of the poor out of poverty; the Japanese and Americans leave most of them there (Figure 22).

[28] December 2007 interview with author.

This has big consequences for both social mobility and income equality. In the US, 42% of children born into the lowest fifth of income levels will remain in the lowest fifth as adults. In Denmark, Sweden, Finland and Norway, the figure is only 24-28%. One reason is that the educational performance gap—how well children of the poor do in math, for example, compared to children of the rich and educated--is lower in the Nordic countries, especially Finland, Norway and Sweden, than in the US. Fortunately, for Japan, its performance gap is one of the smallest in the OECD. This is important because educational equality leads to income equality as well as social mobility (Figure 23a, 23b).

Crisis of the System

In Sweden, a stunning number of people, including young people, are out of work due to health issues and permanent disability, despite the fact that Sweden is quite a healthy country. In 1992, a Health Minister changed the rules so that workers could not get paid for their first day out of work. Absenteeism plunged, prompting some wits to suggest nominating the minister for the Nobel Prize in medicine.

Unfortunately, this problem is typical of the excesses and imbalances that built up during the long period of virtually uninterrupted Social Democratic rule. No matter how good any country's economic model is, notes Ove Pedersen, Director the International Center for Business and Politics in Copenhagen, the model must shift as conditions change. Single-party dominant states have a tough time adapting.[29]

Just as in Japan, some of Scandinavian countries developed a dual economy, combining a highly productivity sector with an inefficient sector. In Scandinavia, the big problem was the rapid rise of public sector employment.

In part, this was an unavoidable response to demographic and social changes. More women wanted to work and, to do so, they required care for their children and aging parents. So, the Nordic countries spent a lot of money on providing child and elderly care and hiring mostly women to work in these centers. There were many positive results from these policies. One was that they helped fight (and partially reverse) a

[29] December 2007 interview with author.

decline in fertility rates.

The problem was not the welfare state per se, but the fact that these benefits were not produced in the most cost-efficient way. Instead of having many private firms providing the services and thus promoting competition efficiency, many people who would be private employees elsewhere were very often public employees in Sweden and Denmark, such as doctors or people doing child care and elderly care. In Norway and Holland, by contrast, even though the government pays for childcare, elderly care and health care services, they are often provided by private companies.

As a result, public employment soared in Denmark and Sweden. Back in 1960, only 12.8% of Swedish workers were public employees, a bit less than in the US and around the same as in the OECD as a whole. But by 1994, public employment had risen to 30%, almost twice the OECD average. It has since stayed around that level. The same trend occurred in Denmark.

Efforts to introduce private enterprise in these publicly-financed services are one of the issues dividing the Social Democrats from the centrist and conservative parties. Former Swedish Social Democratic Finance Minister Par Nuder says, "We have private providers, but it hasn't been a success. It's one thing to aim for higher efficiency, but we have had too many scandals about substandard care by private firms in the elderly care sector. So, I'm not sure it's a success. However, we are not fundamentalists on this issue. We do have private providers in some areas."[30]

Meanwhile, government spending and taxes also had to rise to finance all of these much-desired services. Back in 1960, Swedish taxes were no higher than those elsewhere, 29% of GDP in Sweden versus 26% in the OECD as a whole. But by 1986, they had risen to 50% of GDP. In Denmark, government spending doubled from 23% of GDP in 1958 to 50% of by the mid-1970s (Figure 24). The problem is not the size of government spending per se, but how the money is raised and how well it is used. For example, one of the complaints in Sweden is that, even though corporate taxes are relatively low, job creation is slowed down by heavy reliance on heavy "employment taxes," the premiums for health care, pensions, etc, that firms must pay upon hiring someone slow down job creation.

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[30] December 2007 interview with author.

Such a generous welfare state only works if there are few "free riders" taking advantage of others' generosity. Unfortunately, over time, the number of free riders rose. By the late 1980s, 11% of people aged 20-64 were on sick leave or taking early retirement. The budgetary burden became increasingly unsustainable. Today, the problem is even bigger (Figure 25).

Says Swedish State Secretary Hans Lindblad, "It should be profitable to work, but we should also have a well-functioning publicly-funded welfare system. The Social Democrats abandoned that model a couple decades ago, making it too generous to live on the welfare system. We came to a point where it was not stable any longer, especially considering the aging of the Swedish society."[31]

By no means were all the problems were in the public sector. On the contrary, just as in Japan, anti-competitive devices hindered private sector efficiency. During the 1970s and early 1980s, both Sweden and Denmark made futile efforts to maintain some of their very large “sunset” industries, particularly textiles and shipbuilding, through outright government subsidies and a series of currency devaluations that made Sweden's exports cheaper on the international market. This all backfired, says Sweden's former Social Democratic Industry Minister Thomas Ostros. "The continuous devaluations gave industry the feeling that it didn't have to be on the cutting edge. They felt that the government would protect them through devaluation. The result was that productivity growth slowed, inflation went up and real wages suffered."[32]

Beyond that, Sweden legally allowed various sorts of cartel activity, such as letting competing firms divide up markets. Stefan Folster, chief economist, Confederation of Swedish Enterprise, explained, "Cartels were legal. They would divide up the country and companies would have monopolies in their region. They were quite common."[33] McKinsey Global Institute contended that "toothless" competition laws in effect allowed companies to fix prices across entire industries.[34] Just as in Japan, Sweden and Denmark imposed regulations--from limits on large-scale stores to regulations concerning hours--aimed at protecting mom and pop shops.

[31] December 2007 interview with author.
[32] December 2007 interview with author.
[33] December 2007 interview with author.
[34] McKinsey Global Institute 2006.

Eventually, these drains on productivity took their toll on long-term growth, reversing what had been a remarkable period of catch-up growth. From 1950 through 1975, Sweden had risen from the 7th richest country among 19 OECD countries to 3rd, from 74% of US per capita GDP to 92%. Then the process reversed. By 1995, Sweden had fallen in the ranks to only 14th and only 76% of US per capita GDP. Denmark went through a similar, albeit milder, reversal of fortunes. (Figure 26). The end result was the crisis of the 1980s-early 1990s that we discussed at the outset.

The Way Back; Center Parties Abandon Neoliberalism

The good news that it was possible to fix these problems by making adjustments within the Scandinavian model, not by throwing out the whole model. At the time, however, there were those who argued that the whole welfare state system had to go. Back in 1993, the current Danish Prime Minister, Anders Fogh Rasmussen of the Liberal Party, wrote a book, "From the Social State to the Minimal state" pushing a neoliberal approach akin to that of Reagan and Thatcher. The current Swedish Prime Minister, Fredrik Reinfeldt of the Moderate Party, took the same line during the same year in a book called, "The Sleeping People."

However, the experience of trying to rule with such policies, and then suffering eventual defeat, forced both to abandon neoliberalism.[35] In fact, the Swedish party now refers to itself as "the new Moderates," in a deliberate echo of Bill Clinton's talk of "the new Democrats" in the US.

[35] In the Danish case, the Conservative-Liberal government that came into power in 1982 pursued a confrontational posture toward labor and an imitation of Thatcher in various policy lines. The result was a series of big strikes. In 1982/83 the dock-workers went on a strike (*not* authorized by the union federation), which evolved into a direct confrontation with the government, including violent confrontations between the unions and the police. The strike ended with union defeat. Then, in 1985, several collective agreements expired. The left wing in the trade union movement had success in mobilizing the rank and file members for the popular demand for a 35 hour work-week. But the employers' organizations gained support from the conservative-liberal government. In a break with decades of tradition, the government simply dictated new collective agreements by law, agreements seen as very favorable to the employers. This resulted in massive strikes and demonstrations involving more than a half-million workers, a huge number for such a small population. Though these strikes, too, were defeated, the experience changed both sides. In 1992 the Social Democrats ousted their leader, turned to a more moderate leader, and returned to power. Today, it is the Liberals, not the Conservatives, who lead the center-right coalition government and those liberals are less "neoliberal" in their thinking.

"I am very much a new Moderate," says Hans Lindblad. In fact, his boss, Finance Minister Anders Borg, was a key architect of the party's change. "When I looked at the polices of the old Moderates, it was clear to me that the party did not deserve more than 10% of the vote because their policies only benefited 10% of the people. We had to adapt to what are ordinary people's problems today, not just what were rich people's problems yesterday. We feel that we have to do reform in small steps. In addition, we have to make sure that the effect of reform on income redistribution is regarded as fair. If reforms are not accepted by the people, you cannot implement them."[36]

The same process occurred in Denmark. "If we had spoken 15 years ago," explained Danish Employment Minister Claus Hjort Frederiksen, "I would probably have said that some of the problems in our country were that unemployment allowances were too high, that social benefits were too high, that we had to strengthen the private sector, and weaken the public sector. But, as the years have gone by, we realized that there is a great consensus in the Danish society that, if you lose your job or get sick, you should be able to keep up your standard of living and not lose your house, that you should have free education and health care. We see these as basic elements in the modern welfare state. We could see that we lost elections because people were scared that we would be too harsh. So, 1998 when we lost the elections by one seat in parliament, we decided that we had to change our policies and establish that we were in the center of the Danish political spectrum."[37]

The Social Democrats, too, have had to moderate their views, although they have been less enthusiastic to talk about it. Still, says former Swedish Social Democratic Finance Minister Nuder, "The differences between the two Social Democrats and the center-right coalition has narrowed. That's because the two extremes—Communism and neoliberalism—have both failed. In fact, in the last election, the Moderate party claimed they were better Social Democrats than we were."[38]

The precondition for every other reform was restoring macroeconomic stability, a path pursued by both Social Democratic and center-right coalitions. Today, the Scandinavian countries run steady budget and current account surpluses, along with low

[36] December 2007 interview with author.
[37] December 2007 interview with author.
[38] December 2007 interview with author.

and stable inflation. They have disciplined their monetary policy and their currencies by tying themselves to the Eurozone.

However, it took unpopular measures, including spending cuts and tax hikes, to achieve this stability. In Sweden this amounted to a swing in the budget balance equal to 15% of GDP in just five years. Some of this came naturally through economic recovery. But much of it did come from unpopular policy measures. This hardly rolled back the welfare state; in 2006, spending as a share of GDP was 51% in Denmark and 55% in Sweden. But it did mean some tightening up on benefits, such as raising the retirement age, slightly reducing the size of unemployment benefits in Sweden and enforcing stricter go-to-work requirements in Denmark. In many cases, these reforms were passed by a consensus agreement between the Social Democrats and the center and right parties.

State Secretary Lindblad claimed that the measures passed by his center-right coalition are already working. "When we took over in 2006, a nurse on sick leave wouldn't gain a single krona [the Swedish currency] by going back to work. We reduced unemployment compensation allowances and made a smaller reduction in sick leave pay, and we stepped up monitoring to ensure that those who are able to work do in fact go back to work. Already, sick leaves are down 13%. The one million people out of work that I mentioned earlier (see again Figure 23) has come down by 164,000 people in the last year."[39] Of course, some analysts—including a Moderate party member of parliament with whom we spoke--said that the job growth and reduction of people on sick leave and early retirement has more to do with the ongoing economic boom than the reforms.

Even the Moderate and Liberal parties follow a very different approach from their conservative counterparts in the US, UK and Japan. For example, these parties argue that the unemployment program is so generous and taxes are so high that a low-skill worker does not substantially improve his finances by going to work. Rather than drastically cutting benefits, the Moderates and Liberals either already have, or are proposing to, cut taxes on these low income workers to give them more incentive. What a far cry from the Reaganite emphasis on tax cuts for the wealthy.

[39] December 2007 interview with author.

Globalization, Competitions and Productivity

Macroeconomic stability is just the precondition. The real work is enhancing the growth and efficiency leg of the three-legged stool. Some of this has been achieved by far-reaching deregulation of heavily regulated or state-owned enterprises, such as telecommunications.

Perhaps even more important were measures that increased competition in the private sector. One of the chief weapons in this effort was exposing more of the domestic economies to international competition. Sweden, Norway and Finland joined the European Union in 1995; Denmark had already joined the European Community in 1973.

Joining the EU meant adhering to EU competition laws. Many of the anti-competitive devices had to be scrapped. "In joining the EU," explained industry federation economist Folster, "Sweden had to introduce competition law, which didn't really exist before that. Deregulation of restrictions on large stores has caused high food prices to drop toward EU levels."[40]

However, Folster stressed, the real competitive impact came not from following EU rules, but from the increase in globalization on the ground. The ratio of trade to GDP (in current prices) in Denmark and Sweden rose from about half of GDP in the 1960s to around 90% today (Figure 27a). The cumulative stock of inward Foreign Direct Investment (FDI) soared from 5-7% in 1990 to around half in 2006 (Figure 26b). On the import side of the equation, the main benefit was an increased in competition which spurred domestic firms to either improve or stand aside. "Having a domestic monopoly doesn't give you that much power when imports are half of the market," said Folster.

At the same time, Sweden upgraded its "human capital," says Ostros. "In three years, from 1994 to 1997, we turned a budget deficit equal to 12% of GDP—a record for a modern industrial country--into a surplus. However, even during this period of budget-cutting, we invested heavily in education, including adult education, and R&D." Sweden rapidly increased the number of PhD-level engineers as well as adult education for ordinary workers. Meanwhile, spending on Research and Development (R&D) increased

[40] December 2007 interview with author.

to 4% of GDP, of which 1% is government money and 3% private industry money.

The result was a technological transformation of the country. Back in the 1970s-80s, Sweden's exports focused on resource-intensive and medium-technology products. But in the last decade, with global competitors like Ericsson, Sweden has become a high-tech power. During the 1990s, the share of medium-high and high technology industries in Sweden’s trade increased from 18% to 25%. Since the majority of Sweden’s high tech products are exported, the export drive led a domestic transformation. By 1999, 10% of Sweden’s private sector GDP consisted of high-tech and medium-high-tech goods and services, higher than the OECD average of 8.8%.

In certain key industries, intensified competition forced leaps in productivity, according to a 2006 study by McKinsey Global Institute. Back in the early 1990s, automotive productivity in Sweden was 20% below that in Japan. Today, Sweden's auto productivity is as high as in Japan, 5% higher than in the US and 40% higher than in Germany and France. Back in the 1990s, retail productivity was 20% behind that in the US. Since then, deregulation and new competition has caused retail productivity to leap ahead 4.6% a year.[41]

In Sweden, this was definitely done via a "big company" model. For example, Ericsson's R&D alone comprises 1% of the entire 4% of GDP in R&D done by Sweden. Another 1% is done by AstraZeneca, the world's seventh largest pharmaceutical firms. So, two firms do half of Sweden's entire R&D. Just ten companies account for a full 40% of all Swedish exports.

In Denmark, a similar process of globalization-led productivity reforms occurred following the 1986 decision by the EU to create a true single market across the EU. However, Denmark's capitalism is that of small and medium sized firms. And, rather than produce high-tech products, Denmark uses high-tech processes in ordinary products.

The whole experience of crisis and recovery has taught the Nordics the skills of adaptability, says Ove Pedersen. Crises are endemic in capitalism, says Pedersen, so the key thing for a country is to institutionalize mechanisms that provide an early warning system and the ability to adapt. "Openness and adaptability are closely linked. But the link has to be there for a number of years. You develop the skill of adaptability, by being

[41] McKinsey Global Institute 2006

forced to adapt. As small, open economies, the Scandinavians have been forced to learn adaptability. The learning mechanism has been institutionalized into our consensus decision-making politics."[42]

In Japan, by contrast, competition from globalization lags. The stock of FDI is low relative to GDP. Despite an increase in the price-adjusted ratio of exports and imports to GDP, Japan not only imports too little, but also exports too little for a country with its population, per capita GDP, and distance from trading partners--at least as measured by nominal trade, the only data we have (Figure 28). Moreover, a very large proportion of the increase in manufacturing trade is with Japan's overseas affiliates (e.g. Matsushita importing TVs from its affiliates in Malaysia while exporting parts to it, rather than Japan importing Lucky Goldstar TVs and exporting parts to it). From fiscal 1996 through 2005, 22% of the increase in total imports (not just manufacturing imports) came from Japan's own affiliates. During the same period, a whopping 62% of the growth in total exports was in exports to Japanese affiliates, mostly in Asia. While interfirm trade is a widespread phenomenon, it is intrafirm trade that really provides a competitive kick.

Future of the Scandinavian Welfare State

Can the Scandinavia welfare state survive? It has many assets going for it. But it also faces two major challenges.

As in other industrial democracies, one of the biggest challenges is aging. In Sweden, the working age population will start to fall in 2008. Denmark, the working age population is projected to fall from 67% of the total population today to 62% by 2030. Certainly, this can be countered by fighting early retirement or the number of people on sick leave. Klaus Rasmussen, Chief Economist at the Confederation of Danish Industries, says cutting taxes on middle and upper-income people would lead them to work more hours, though this is in dispute even by members of the Liberal Party.[43]

But the real answer is good productivity growth. Certainly, Sweden has done a lot

[42] December 2007 interview with author.
[43] December 2007 interview with author.

better than in the past, 2.5% a year growth in private sector growth per worker since 1995, and 2% a year overall. Looking at GDP per hour, rather than per worker, Sweden also shows superior results: 2.4% a year during 1995-2004, nearly twice the Eurozone rate of 1.24% and just behind the US at 2.5%. Finland and Norway have also done well in the last decade at 2.3% and 2.2% respectively (Figure 29). Looking at growth in Total Factor Productivity (TFP), Finland and Sweden came in third and fourth among 18 OECD countries at 2.2% and 1.6% a year respectively during 1995-2005. They both beat the American achievement of 1.55%. But economists are not sure if this is just a temporary spurt resulting from the past decade of reforms, or whether it can be sustained.

On the other hand, while Denmark has done better than the rest of Europe, it has not done as well as Sweden, Norway or Finland. Denmark's growth in GDP per worker were 2% a year in the private sector and 1.6% overall during the last decade (review Figure 1). Looking at GDP per hour rather than per worker makes the recent Danish figures look disappointing, only 1.3% a year, less even than the Eurozone's 1.4% (see Figure 29 again). Moreover, this is less than half the Danish growth rate of 2.4% during 1985-94. Denmark also did very poorly in the last decade when it comes to TFP growth: virtual zero growth. This is a sharp comedown from 1985-1995, when Danish TFP grew 1.5% a year, the fourth highest in the OECD and significantly higher than America's 0.9% growth rate.

Why, despite all of the other Danish achievements in GDP per capita, GDP per worker, lowering unemployment and such, has Danish productivity as measured by GDP per hour and TFP done so poorly? It's especially mysterious considering the both the performance of other Nordic states and the particular fluidity of Danish labor markets and the high rate of firm turnover. Danish Employment Minister Claus Hjort Frederiksen argues that, as Denmark drew more lower-skilled, less productive workers form the unemployment rolls into work, that dragged down the average.[44] Hence, there is the possibility that productivity growth will accelerate further in the future. Private sector productivity growth (per worker) did accelerate to 2.5% a year during 2003-06. And Denmark's growth in GDP per hour revived to 1.8% in 2003 and 2.4% in 2004 (Sweden's was 2.7%). But it remains to be seen whether this improvement will be sustained.

[44] December 2007 interview with author.

Without even more improvement in productivity growth, many economists believe that Denmark's long-term potential GDP growth could be limited to 1.5% a year. That makes it is disappointing that neither Rasmussen of the employers federation nor Steen Jorgensen, an economist at the Danish Confederation of Trade Unions, place much emphasis on increasing productivity growth. Indeed, Jorgensen dismisses the poor figures in the public sector and services in general as a measurement problem.[45]

Besides better productivity growth, the other long-run answer to the labor shortage is more immigration, says former Swedish Finance Minister Par Nuder. But immigration poses big problems both economically and politically. Already in Denmark, immigrants have risen from less than 3% of the population in 1980 to more than 6% today. In Sweden, immigrants have risen from 4% of the population in 1960 to 12% today. Unlike a few decades ago when most immigrants to Sweden were recruited to shore up the labor force, today, almost half of all immigrants to Sweden are refugees from the former Yugoslavia, the Middle East or other trouble spots. Both skill levels and employment levels are lower among immigrants (e.g. 81% employment rate among native-born Danes versus 66% among the foreign-born) and reliance on social benefits is higher.

The third challenge, striking at the heart of the Scandinavian model, is the growth of "free riders," who take advantage of the system by using sick leave or unemployment benefits excessively. How to deal with this is one of the major divisions between the current governments in Denmark and Sweden and the opposition Social Democrats.

As in other parts of Europe, many Danes and Swedes complain that immigrants take advantage of the social systems benefits without contributing enough. There is a bit of a backlash, though it is less severe than in countries like France. The Swedish anti-immigrant party is very rightist and none of the mainstream parties will work with it. It won only 3% of the vote for parliament last time, but it won lots of seats in municipal elections. In Denmark, the anti-immigrant party is far milder and far bigger. It won 13% of the vote in the most recent election.

Can the Scandinavian welfare state survive as the society becomes more

[45] December 2007 interview with author.

heterogeneous or does it depend on a feeling of community that based on the notion of everyone being alike? Optimists say the immigration issue has been around for a long time and it can be dealt with; others are not so sure.

These problems are hardly unique to Scandinavia. So, just as the rest of the world is watching how Scandinavia is successfully dealing with other problems faced by rich countries, such as unemployment and globalization, so it will watch how it deals with aging and immigration as well.

Scandinavia Is Not Unique; Globalization and Social Safety Nets Go Together

If the Scandinavian blend of market efficiency and globalization with egalitarianism and a strong social safety net were unique, then the prospects of Japan or the US or any other country emulating the best parts of its model would be very limited. But the fact is that some of its features are seen in many other countries in Europe.

Importantly, this trend refutes a false proposition commonly accepted on both the left and the right: that globalization makes it impossible for states to provide social welfare and social insurance or income equality, that globalization implies a "race to the bottom." Supposedly, countries with strong social welfare policies and income equality will be less competitive in trade markets while foreign capital will flee states that raise taxes to finance social welfare measures.

Ever since political scientist Peter Katzenstein wrote *Small States in World Markets: Industrial Policy in Europe*[46] back in 1985 it has been known what many small states with high levels of foreign trade, not just those in Scandinavia, provide high degrees of income equality and social welfare through government measures. A spate of research by economists since then has documented and updated Katzenstein's findings.

In fact, the "race to the bottom" thesis has it exactly the opposite. In reality, countries that are more open to trade tend to spend even more on social welfare measures. Trade and social welfare spending, in fact, amplify each other. For good reason. Social welfare spending provides the safety net that makes populations willing to accept the

[46] Katzenstein (1985)

risks of globalization. In turn, free trade provides the higher growth that helps finance social welfare measures.

Compare the social safety net to fire insurance or a futures market in farm products. Because people can buy fire insurance, they are more willing to buy their own home and so more homes get built and bought. Because farmers can get a guaranteed price for their products months in advance—and shift the risk to someone else—they are more willing to grow more food. We get cheaper food as a result.

On the one hand, trade and FDI enable a country to grow faster and get richer—on average. On the other hand, trade and FDI create more variance and dislocation. Firstly, they can cause more variance in growth from year to year, e.g. Scandinavia went into depression partly as a result of the collapse of their export market in the Soviet Union. Secondly, they create more variance among the country's citizens, e.g., more factory closings, more shifts from job to job, more dislocation for those with little education, growing inequality of income, etc. Consequently, countries that are more globalized face political pressure either to close off trade or to fight these dislocations with government policies. Typically, the left calls for protectionism while the right calls for small government. In reality, small countries are in no position to run autarchies and, increasingly, neither are large ones. The products of modern life require a division of labor involving tens of millions, or hundreds of millions of people. Imagine a country of 10 million trying to produce all its food and cars and chemical products, etc. Hence, on average, countries that are more globalized find it necessary to protect their citizens.

Katzenstein himself discussed the research documenting this trend in a 2003 essay entitled, "*Small States* and Small States Revisited." He writes:

> David Cameron had demonstrated that openness to international trade correlates highly with social spending levels that were exceptionally generous in small states. Two decades later Geoffrey Garrett consolidated that finding. Updating Cameron's trade analysis and extending the analysis of trade to capital markets, Garrett's statistical analysis supports the conclusion that openness does not undercut national choice, including for social democratic regimes that seek to strike a balance between efficiency and equity. Garrett's provocative analysis is a useful corrective to the view, widely shared in the 1990s, that

footloose capital was all but eliminating national choices.[47]

Cameron, for example, found that the best single predictor of an increase in the tax share of GDP among OECD countries between 1960 and 1975 was the economy's trade:GDP ratio in 1960.[48] The correlation was a very high 0.78. One of the best recent studies documenting, explaining, and expanding on upon this finding via careful econometric regressions involving 100 countries is Dani Rodrik's "Why Do More Open Economies Have Bigger Governments."

> There is a positive and robust partial correlation between openness, as measured by the share of trade in GDP, and the scope of government, as measured by the share of government expenditure in GDP…[This pattern] prevails for both low- and high-income countries…In addition, openness in the early 1960s is a statistically significant predictor of the *expansion* of government consumption over the subsequent three decades [emphasis in original]…
>
> Government consumption appears to play an insulating role in economies subject to external shocks. Societies seem to demand (and receive) a larger government sector as the price for accepting larger doses of external risk.[49]

A couple back of the envelope calculations show that Rodrik's finding still holds today despite all the talk of "a race to the bottom." As we can see in Figure 30a, among OECD countries, those that trade more (higher trade:GDP ratio) have higher government spending on social services as a share of GDP. Nor do rich countries have to worry about driving away foreign capital if they spend "too much" on social spending. There is no statistically significant relationship between inward stock of FDI and social spending (Figure 30b). Countries with high social spending neither attract nor repel FDI.

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[47] Katzenstein (2003), pg. 11.
[48] Cited in Rodrik (1996), pg. 2.
[49] Rodrik (1996)

Can The Land of The Rising Sun Learn From the Lands of the Midnight Sun?

"How do you like being a star, with everyone coming to learn from you?" we asked Danish Employment Minister Frederiksen. He laughed and then, like so many others in Denmark and Sweden, discounted the notion that others could simply copy a complex multi-part system that has taken the Scandinavians decades to build. Moreover, said Frederiksen, "I don't believe in the 'one size fits all' approach. Each country has to adopt the practices that suit it best." Then, in virtually the same words used by everyone else we spoke to, he concluded, "You can't copy us, but it is possible to learn from our experience."

The good news is that one of Japan's best skills as a nation, ever since the 1871 Iwakura Mission, is learning about the "best practices" of other nations and then adapting them to Japanese needs and ways of doing things.

The first lesson for Japan in learning from Scandinavia is that this is not like a "combination platter" menu at a Chinese restaurant: one choice from column A; two choices from Column B. Many parts of the Scandinavian model only work well because they are linked to other parts. For example, neither flexibility nor security works well without the other. As Frederiksen explained, "I have had many visits at this table over the past five years from French ministers and politicians, German ministers, Spanish ministers. They are all very interested in the flexibility part of our system, i.e. the easier rules for hiring and firing people. However, when it comes to the crux of the system, the security part, then their interest drops. That's because it means they have to spend a lot of money to pay these high allowances and run these active labor market policies."[50]

This does not mean that it's an "all or nothing" proposition, but attention must be paid to the mutual dependence of various policy planks.

The second lesson is that even the best policies don't work unless they have a supportive institutional context. The same policies work differently in different countries because people behave very differently depending on the institutional context.

What is it that makes the flexicurity philosophy so popular, workable, and sustainable in Scandinavia? At least one answer is one that might meet the approval of

[50] December 2007 interview with author.

Mancur Olson: very inclusive institutions built up over decades. In Denmark, about 80% of workers are in unions, while the employers federation includes companies with 55% of all private sector workers. Similar trends prevail in Sweden.

Because of this centralization, when workers and firms bargain, they don't just think about their own firm or industry; they have to think about the impact on the economy as a whole. Unions know they cannot demand such high nominal wages as to price their exports out of the market or force inflation. That's one of the reasons Sweden's employers federation returned to coordinated bargaining after having withdrawn in 1990. At the same time, management knows it must enhance the skills and safety of the labor force to compete. The Scandinavians have a very low rate of workplace injuries.

An example of this was shown in a study on the differences of Danish and British company responses to retraining programs. Professors Cathie Jo Martin of Boston University and Duane Swank of Marquette University found that, because Danish employers are organized into a high centralized federation, they have a sense of their collective interests as employers. They see training as a "public good" from which they will ultimately benefit as knowledge diffuses throughout the labor force. Moreover, Danish companies are more willing than British firms to pay taxes for active labor market programs and participate in on the job training programs like the House of Prince we discussed above. In Britain, where employers are less centrally organized, companies are more likely to take an attitude of "every man for himself." They hold back on training out of fear that the money they spent on training might be lost as the upgraded worker went to another firm.[51]

The thinking is different in Scandinavia, explained Professor Steen Navrbjerg of the University of Copenhagen, "A Danish CEO told me that, if he trained a worker, the risk was that the worker would leave. But, said the CEO, there was a bigger risk. What if he didn't train the worker and that worker stayed?"[52]

At present, big Japanese firms deal with this dilemma by practicing "internal flexibility," i.e. on the job training and job shifting with the firm. So, they get the benefit from their investment in training. But this causes Japan to lose "external flexibility" and

[51] Martin and Swank (2004)
[52] December 2007 interview with author.

makes the worker too dependent on the fortunes of his own firm. It also works a lot less well for the vast majority of Japanese who work for small and medium firms. And it also works a lot less well for big firms in sunset industries.[53]

The third lesson is that, after a while, institutions create attitudes that reinforce both the institutions and the policies. The ability of these policies to work well depends on these attitudes. Creating these attitudes cannot be accomplished overnight.

Trust is one of the most important attitudes, emphasized Soren Andersen, a specialist in labor-management relations at the University of Copenhagen. "Scandinavian workers are willing to provide firms with flexibility because they really trust that they will get security in return." Workers embrace globalization and technological improvement because they trust that they will be taken care of if they lose their job. They are willing to pay high taxes because they trust that the revenues will be used in a universalistic system that provides benefits for most people. Employers trust that if they support the system of security and equality, they will get flexibility. Long experience has shown that this trust is rewarded. Trust is not easily or quickly built. "The other day, I had a visit from French unions who wanted to learn about Flexicurity," said Andersen. "They liked the security part. But, they felt, that, even if they offered employers more flexibility, they wouldn't get society-wide security in return. They'd just get 'Flexploitation' [a combination of flexibility and exploitation]."[54]

Another important attitude is that social benefits are designed to enhance the feeling of all citizens that "we're all in this together." Benefits like free health care or free child care are "universalistic," i.e. they are provided to everyone, not just to the "deserving poor." As a result, most everyone feels that, "We pay high taxes, but we're also the ones who get the benefits. We all get sick. We all need education. We all risk losing our job. We all get old."

Former Swedish Finance Minister Nuder underlined that the universality of the benefits generated both efficiency and trust in the system. "A universal system can be cost-effective. Compare our health system to that in the US. Secondly, there is no doubt that the universality of the system is critical to maintaining political support for it. Even

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53 Bredgaard and Larsen (2007).
54 December 2007 interview with author.

the wealthiest Swedes can take benefits from the system. We don't want a system where you have to pinpoint those who are in need for others' charity. In the long run, that would lead to a situation where the rich and the middle class start to question why they should pay high taxes if they don't get the benefits."[55]

This is also, by the way, why the perception of refugee immigrants or others taking advantage of sick leave or unemployment benefits is so corrosive: it undermines the trust and social cohesion that is the sine qua non of the system.

By contrast, in countries like the US where, among non-retirees, only the poor get free medical care, many citizens feel: "We pay the taxes, but they get the benefits." Hence, voter support for such programs is low. Similarly, as more American parents, dissatisfied with the public schools, send their children to private schools, they are less willing to pay taxes to support the public schools. So, the public schools get worse and more people abandon them in a vicious cycle.

Without trust, governments can be immobilized. When Scandinavian governments were forced to dispense harsh medicine in the 1980s and 1990s to get out of crisis—and at later points as well--voters swallowed it because they were convinced it would be done fairly. Professors Junko Kato and Bo Rothstein contrast this with Japan, where, "a minimal welfare state and previous policies of directing government funds to special interests (e.g., in the form of construction projects and rice subsidies) meant that the majority of citizens did not consider public expenditures to be particularly useful or legitimate**.** This had a big impact on government's credibility and ability to implement policy. "Social Democrats in Sweden were able to convince the public that increased taxes and cuts in benefits were plausible measures to eliminate deficits and so guarantee the long-term viability of the Swedish welfare state. In Japan, by contrast, arguments about the need to raise taxes to cover government deficits were met with skepticism."[56]

How then, we asked Frederiksen, could a country like Japan switch from a system of job security, i.e. protecting a person at his current job, to the income/employment security embodied in Scandinavia's Flexicurity philosophy. "You could start," he replied, "with making sure that certain benefits are not tied to a single employer. In southern

[55] December 2007 interview with author.
[56] Kato and Rothstein.

Europe, to get a pension you have to work at the same company until you retire. Otherwise you lose all the money you have put into your pension plan. To our mind, this binds people to a single company in a bad way. You have to rethink the concept that it is the company that provides everything from child care to the pension. If that system exists, you cannot create flexibility."[57]

Just as the Anglo-American path is not the only path to reform, neither is the Scandinavian path. We do not live in a "one size fits all" world. Japan needs to pick and choose the combination of global "best practices"—including Japan's own best practices--that work best for Japan. Japan does not need to remold itself into either the American model or the Scandinavian model. It needs to forge a revitalized Japanese model. But in doing so, it can learn from others, just as the Iwakura mission did way back when.

Afterthoughts on Ideology, Circles of Trust, and Transferability

I wanted to add some more speculative ruminations that bear on the transferability of Scandinavian policies to Japan or the US. These comments should be taken in the spirit of "thinking out loud."

One is the role of ideology or "hot button" issues. Outsiders often think of modern-day Scandinavian politics as particularly pragmatic, rational and calm—though, as we stressed at the outset, this was not always the case. One reason, perhaps, is that most of the political divisions center around material issues rather cultural/ideological ones. Matters of material concern can be compromised. But when it comes to principle, status, honor, social identity, or the word of God, compromise feels more like betrayal.

In the US, this not only takes the form of a high political salience for issues like abortion, gun control, and Darwin, but it also invests even material issues—from global warming to the use of phonetics in reading classes to the distributional effects of tax rates--with an ideological fervor and partisan bent.

In Japan, we have the legacy of World War II. Consider how Yasukuni was allowed to interfere so much in Japan-China economic relations. So many of today's

[57] December 2007 interview with author.

leading politicians, in defending Japan's behavior in the 1930s-40s, are defending not just the honor of the nation, but their own grandfathers. Shinzo Abe tried, and failed, to introduce an ideological bent to issues of constitutional revision and educational reform. In his case, it utterly failed. Voters couldn't see his priority on such ideological issues instead of their day-to-day problems. Whether his failure was a problem of the message or the messenger remains unclear. In any case, when society is so polarized around "hot button" issues, it is bound to affect the cohesiveness needed for a Scandinavian-style society-wide social safety net. It also affects how coalitions are built among legislators.

A second issue is trust in government. In Scandinavia, my sense is that government is seen by most people as, at least potentially, an instrument of the general interest and collective will. Historians say this stems from the Social Democratic takeover in the 1930s so that the labor movement saw government as an instrument of its needs and no longer its enemy. Despite grumbling about this or that, people trust government, see the government as an expression of themselves, and are willing to turn over control of half of GDP to it. When a Scandinavian politician proposes to cut taxes, many people may like it but they also ask: what program do you want to cut to finance the tax cut (it is not persuasive in Scandinavia to claim that the tax cut will pay for itself because tax revenues will rise).

In Japan and the US, by contrast, government in particular and concentrated power in general, are more feared, or at least distrusted, as an alien power. Here again I suspect that, for Japan, this is partly a legacy of World War II. Ordinary citizens fear that a government with too much power could run amok. It may also be a reflection of the inordinate power of a non-elected bureaucracy in a one-party democracy. This distrust of power is reflected in the fact that Koizumi was so often attacked as a "fascist" by members of his own LDP for doing things that chief executives regularly do in other rich democracies. And yet, Koizumi's ability to increase the power of the prime minister and gain so much popularity for doing so—especially in the 2005 Diet elections--shows that these attitudes are not immutable.

In today's America, analogous attitudes are reflected in Reagan's slogan, "Government is not the solution; it's the problem," the effectiveness of the "tax and spending liberal" epithet, and Bill Clinton's declaration that, "the era of big government is over."

A final issue relating to Japan is the "circles of trust." My sense is that, in Japan, there is a high level of trust within the "circle of trust," but that these circles are drawn fairly narrowly. Certain patterns of interaction remind me of Robert Axelrod's *Evolution of Cooperation*. [58] Axelrod describes how repeated interaction among even strangers, even enemies, can gradually create not just a behavioral pattern of cooperation, but even an ethic around it. In one stark example, French and German soldiers in WWI trenches who faced the same units for years gradually developed certain rules of thumb about de facto truces during holidays, the Sabbath, certain hours, etc. This behavior gradually turned into an ethic invested with emotion and soldiers disciplined members of their own side who violated the ethic. Finally, to end this cooperative "game," the generals had to move their units so that their soldiers now faced enemies with no history of interaction.

Production *keiretsu* remind me of this sort of cooperation. An executive from Honda once explained why the auto transplants were so reluctant to buy from, i.e. depend upon, American parts suppliers as opposed to their own subcontractors, many of whom moved with them. He said that the just-in-time system and *kaizen* and the like all required absolute trust in the absolute reliability of the partner, and also required that each partner have a very good sense of the other so as to be able to anticipate the other's evolving needs. This is something that could only be built up over years and years. Trust born of endlessly repeated interaction is a very different kind of trust than that born of society-wide morality that dictates how one acts even toward a stranger with whom one has never had previous contact and with whom one will never have contact again. The latter allows a wider circle of trust.

So, when it comes to security, Japanese regular workers justifiably have more trust that their employer will not just thrown them on the dustbin than do American workers. But they don't have the society-wide trust born of the Scandinavia-style social safety net. Can one introduce the society-wide social safety net without the same society-wide circle of trust?

In this "chicken and egg" interplay of ideas and institutions, I suspect that each is both chicken and egg. To mix metaphors, it may seem like a Catch-22: can't change

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[58] Axelrod (1984)

Japanese institutions until one changes attitudes; can't change attitudes until one changes institutions. But the fact is that many of today's institutions, including the labor market institutions, are deliberate creations of governmental and private policymakers during the 20th century. They are not reflections of age-old Japanese culture, but adaptations to a particular situation that have, in some regards, outlived their usefulness.[59] They are not immutable. What people created, people can modify, albeit not overnight. That's what leadership is all about.

[59] For a great series of essays on how many of today's institutions and attitudes in Japan--from alleged non-litigiousness, to *wa*, to the rules of sumo—are modern creations or modern reifications, see Vlastos (1998).

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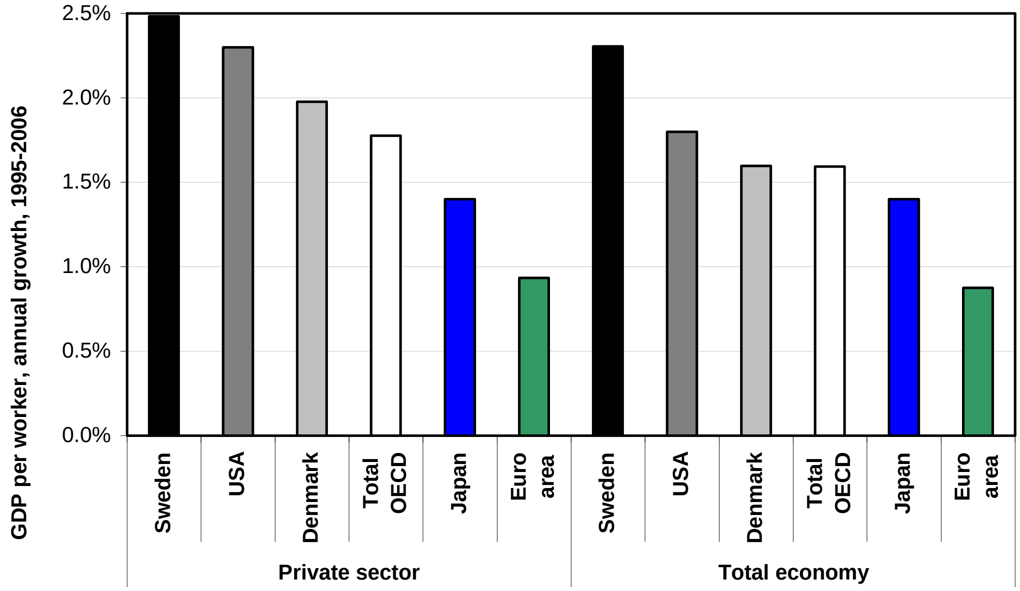
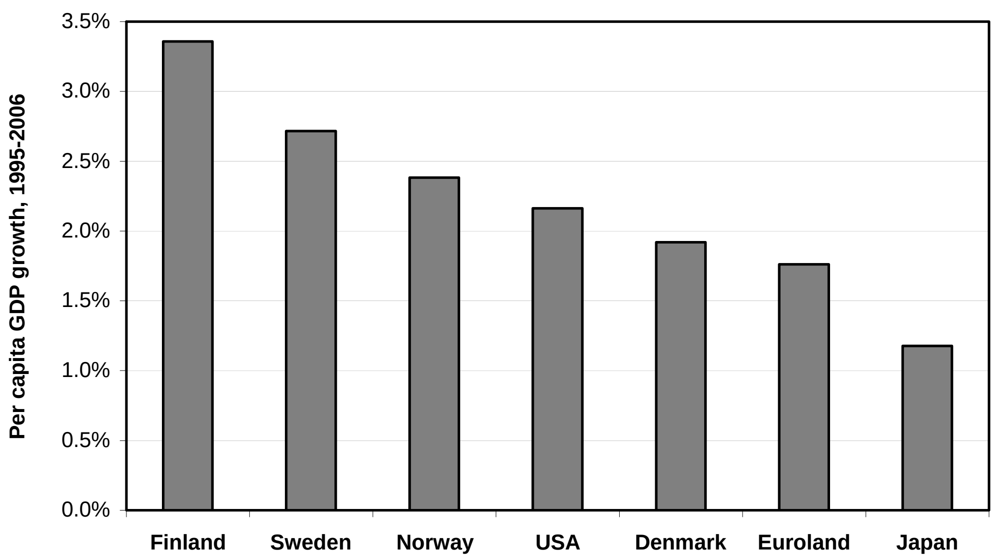
Figure 1: Scandinavians Rediscover Productivity Growth



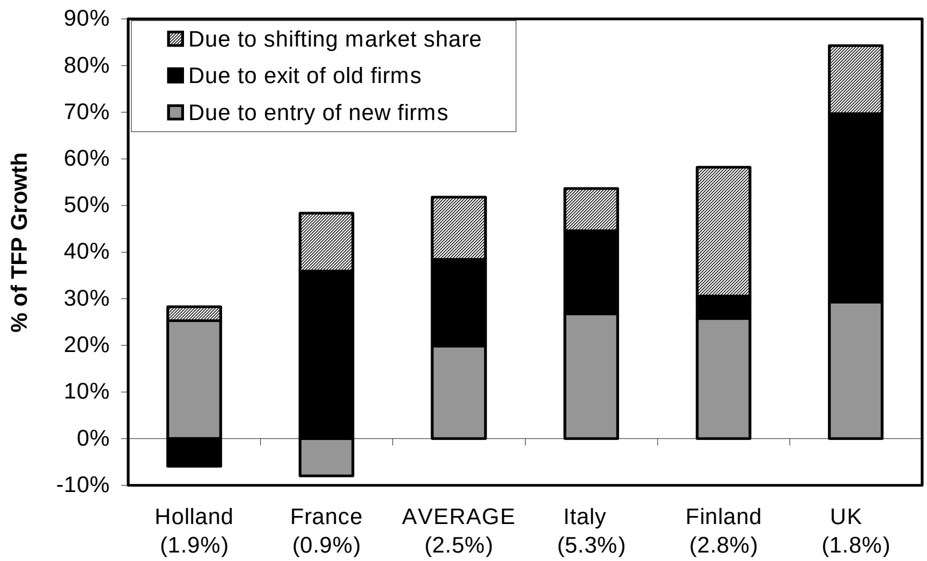
Source: OECD 2007f

Figure 1b Three of Four Nordics Beat US Per Capita Growth



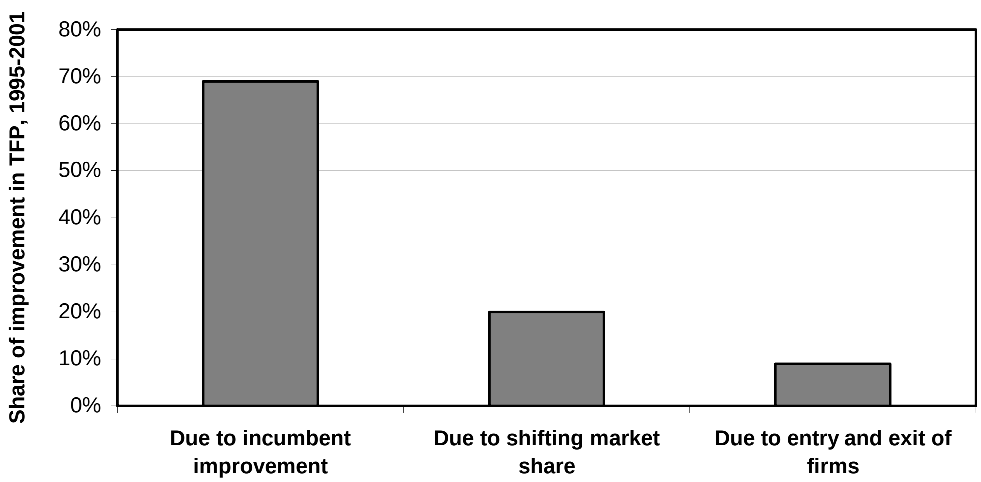
Source: World Bank website

Figure 2a Competition and Firm Mobility Breeds TFP Growth



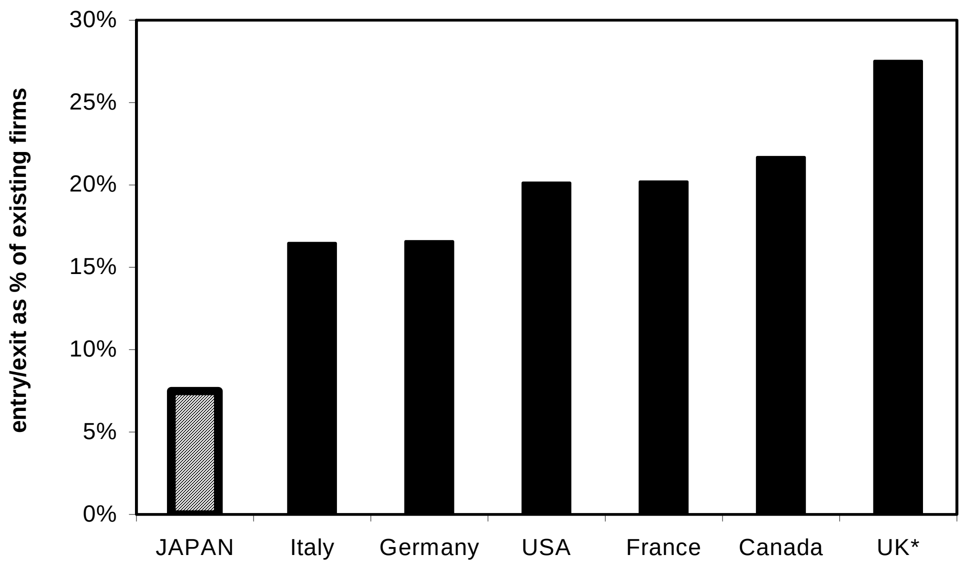
Source: OECD (2001).
Note: Numbers in parentheses are annual average TFP growth in manufacturing

Figure 2b In Japan, Entry and Exit Play a Minor Role In TFP Growth



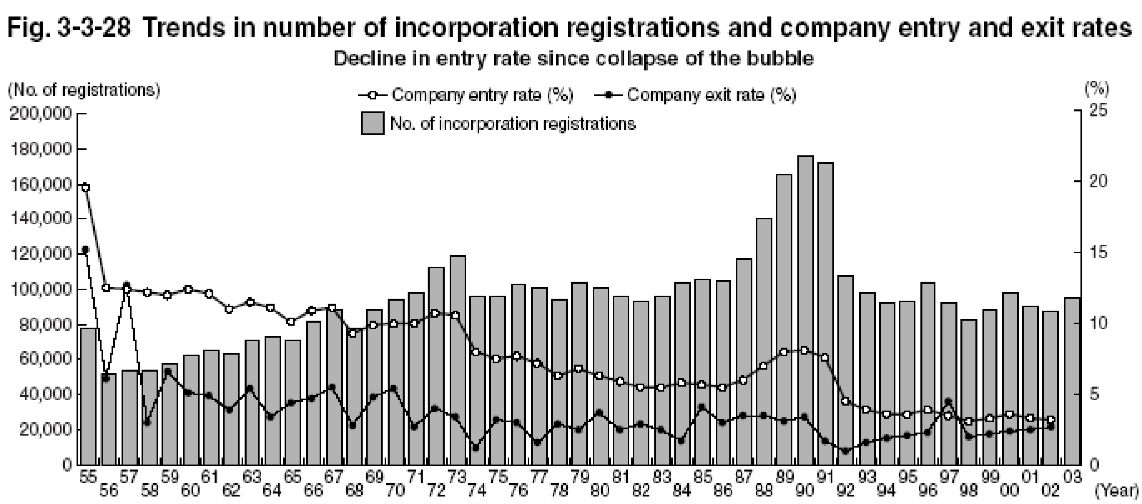
Source: Fukao and Kwon (2005)
Note: Covers years 1995-2001 where total increase in capacity-adjusted manufacturing TFP was 5.4% (average of 0.8% a year). Entry and exit includes firms switching from one industry to another.

Figure 3a Japan Firm Mobility Lags Far Behind G7



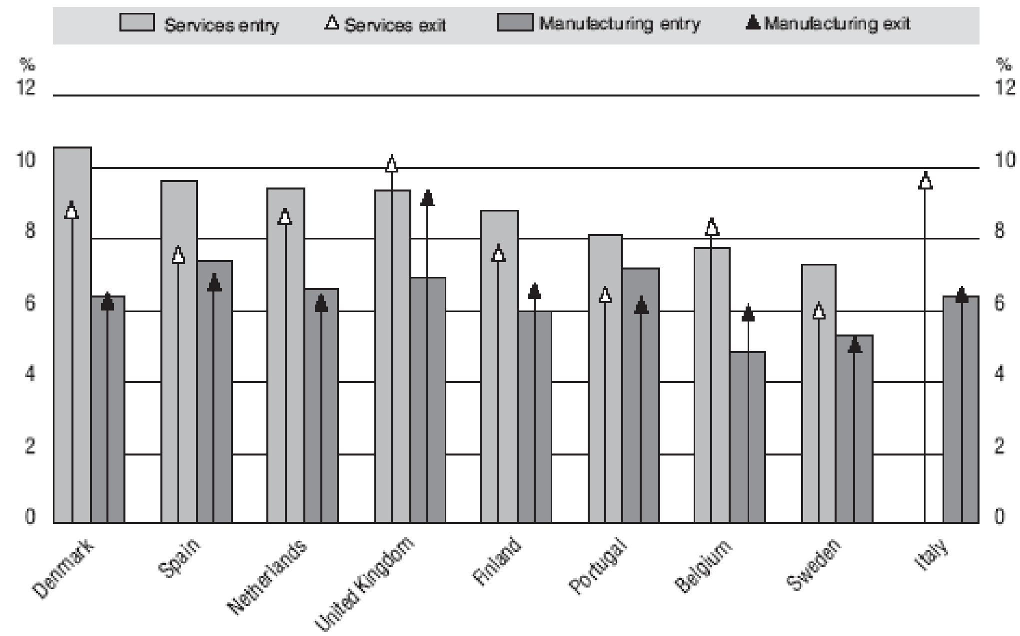
Source: OECD (2001) and Management and Coordination Agency

Figure 3b Exit Rate Still Low, Entry Rate Declining As of 2002



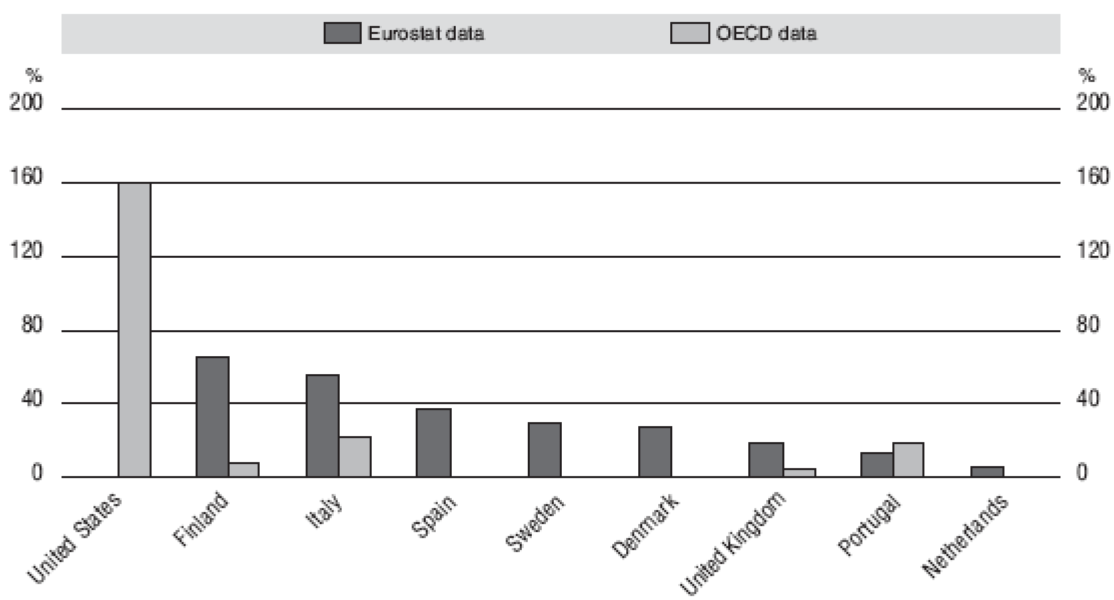
Source: METI (2005)

Figure 3b Denmark Has High Turnover Rate



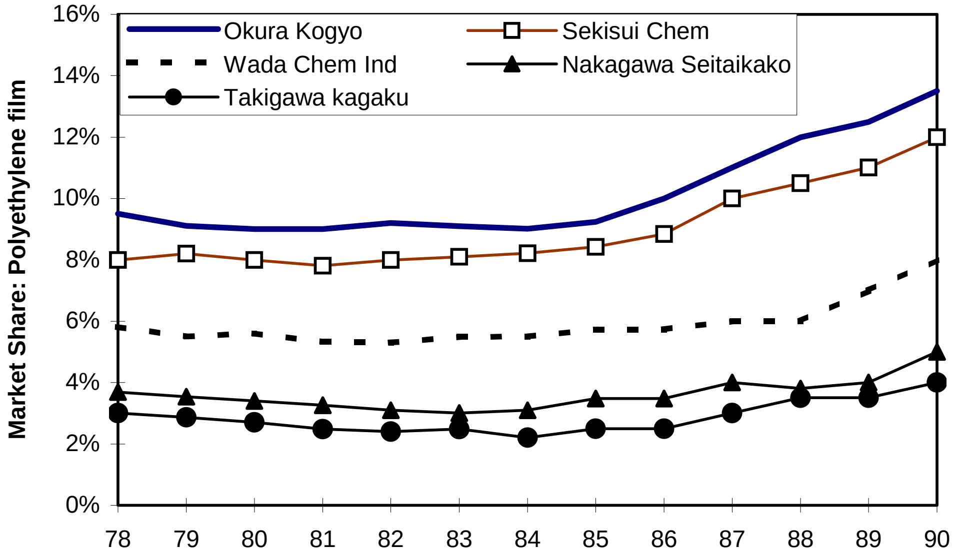
Source: OECD 2004
Note: Data from 1998-2000

Figure 3d US New Firms Can Really Grow



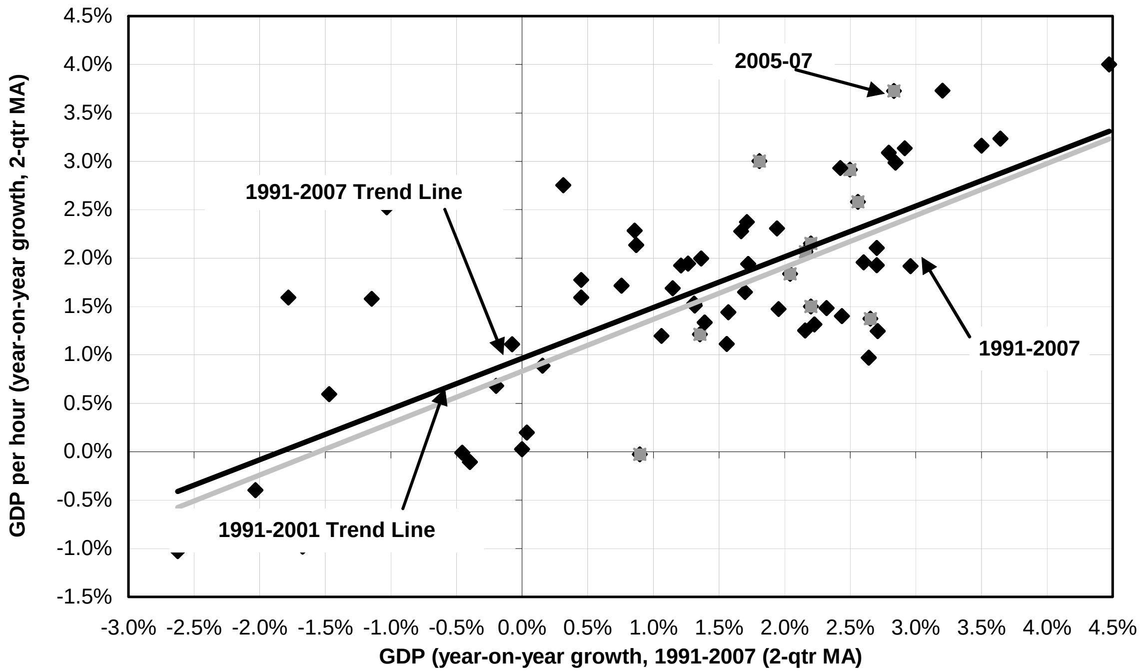
Source: OECD 2004

Figure 4 Competition Too Weak In Inefficient Side of Dual Economy



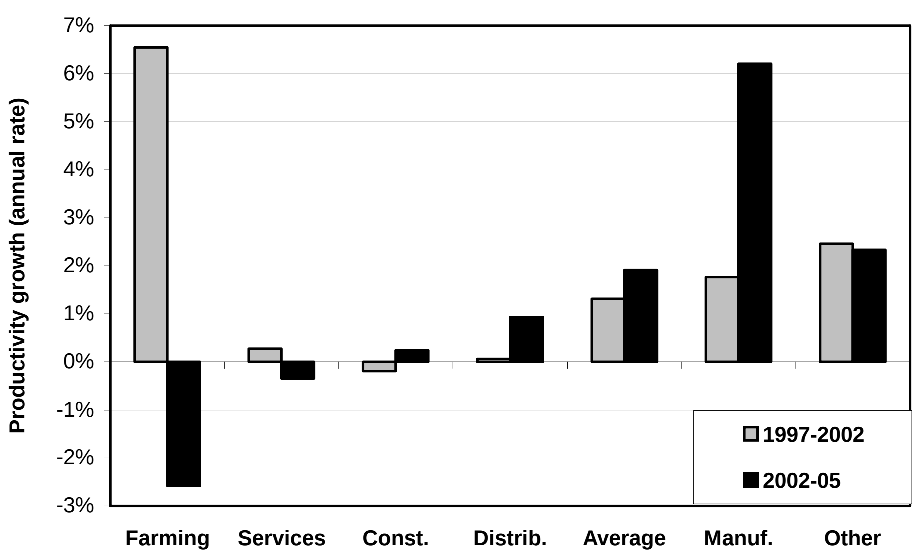
Source: Porter, et. al. (2000).

Figure 5a Little Trend Acceleration in Japanese Productivity Growth



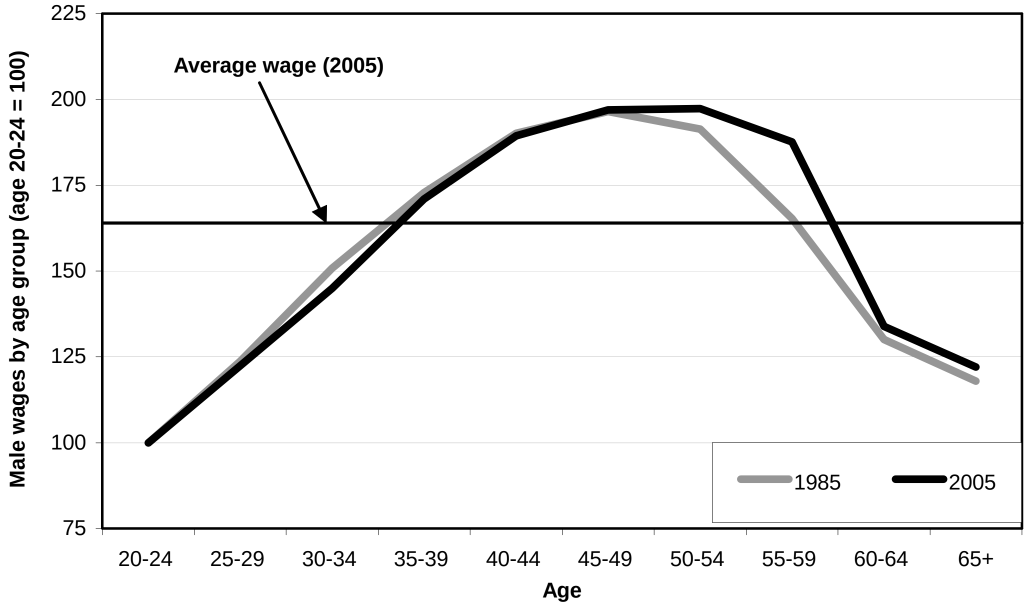
Source: Calculated by author based on GDP and work hours from Cabinet Office and Labour Force Survey.

Figure 5b:
Only Manuf. and Distribution Enjoy Productivity Acceleration in 2002-05



Source: Cabinet Office National Accounts Tables

Figure 6 Seniority Wages Still Prevail



Source: Ministry of Health, Labour and Welfare at
http://www.stat.go.jp/data/nenkan/zuhyou/y1628000.xls

Table 1a: Three Models Of Capitalism

(All ages)

Market distribution of national income

	Poorest 30%	Middle 40%	Richest 30%	Ratio*
Japan	13.7%	35.1%	51.2%	3.7
Finland	10.2%	35.0%	54.8%	5.4
Norway	8.8%	37.0%	54.2%	6.2
Sweden	8.0%	35.0%	57.0%	7.1
Denmark	7.8%	37.6%	54.6%	7.0
US	7.6%	32.8%	59.6%	7.8
Average	8.1%	34.4%	57.6%	7.1

Distribution after taxes and government spending

	Poorest 30%	Middle 40%	Richest 30%	Ratio*
Denmark	17.6%	38.2%	44.2%	2.5
Finland	17.5%	37.2%	45.3%	2.6
Sweden	17.2%	37.9%	44.9%	2.6
Norway	16.0%	37.2%	46.8%	2.9
Japan	15.7%	36.5%	47.8%	3.0
US	11.5%	35.0%	53.5%	4.7
Average	15.2%	36.4%	48.5%	3.2

Impact of government taxes and spending

	Poorest 30%	Middle 40%	Richest 30%
Denmark	9.8%	0.6%	-10.4%
Sweden	9.2%	2.9%	-12.1%
Finland	7.3%	2.2%	- 9.5%
Norway	7.2%	0.2%	- 7.4%
US	3.9%	2.2%	- 6.1%
Japan	2.0%	1.4%	- 3.4%
Average	7.1%	2.0%	- 9.1%

Source: OECD 1998. Data on 12 countries from 1995 (latest available for all the data)
Note: Ratio means the ratio of the income shares of top and bottom 30%

Table 2b: Three Models Of Capitalism

(Working age only)

Market distribution of national income

	Poorest 30%	Middle 40%	Richest 30%	Ratio*
Norway	11.5%	36.0%	52.5%	4.6
Japan	11.4%	35.9%	52.7%	4.6
Sweden	10.9%	36.1%	53.0%	4.9
Finland	10.3%	35.9%	53.8%	5.2
Denmark	9.7%	37.2%	53.1%	5.5
United States	8.6%	32.6%	58.8%	6.8
Average	10.1%	34.7%	55.2%	5.5

Distribution after taxes and government spending

	Poorest 30%	Middle 40%	Richest 30%	Ratio*
Norway	16.4%	36.6%	47.0%	2.9
Denmark	16.0%	42.9%	41.1%	2.6
Sweden	15.5%	42.1%	42.4%	2.7
Finland	14.8%	41.5%	43.8%	3.0
Japan	11.7%	41.3%	47.0%	4.0
United States	10.9%	39.2%	49.9%	4.6
Average	13.7%	39.8%	46.6%	3.4

Impact of government taxes and spending

	Poorest 30%	Middle 40%	Richest 30%
Denmark	6.3%	5.7%	-12.0%
Norway	4.9%	0.6%	-5.5%
Sweden	4.6%	6.0%	-10.6%
Finland	4.5%	5.5%	-10.0%
United States	2.3%	6.6%	-8.9%
Japan	0.3%	5.4%	-5.6%
Average	3.6%	5.0%	-8.6%

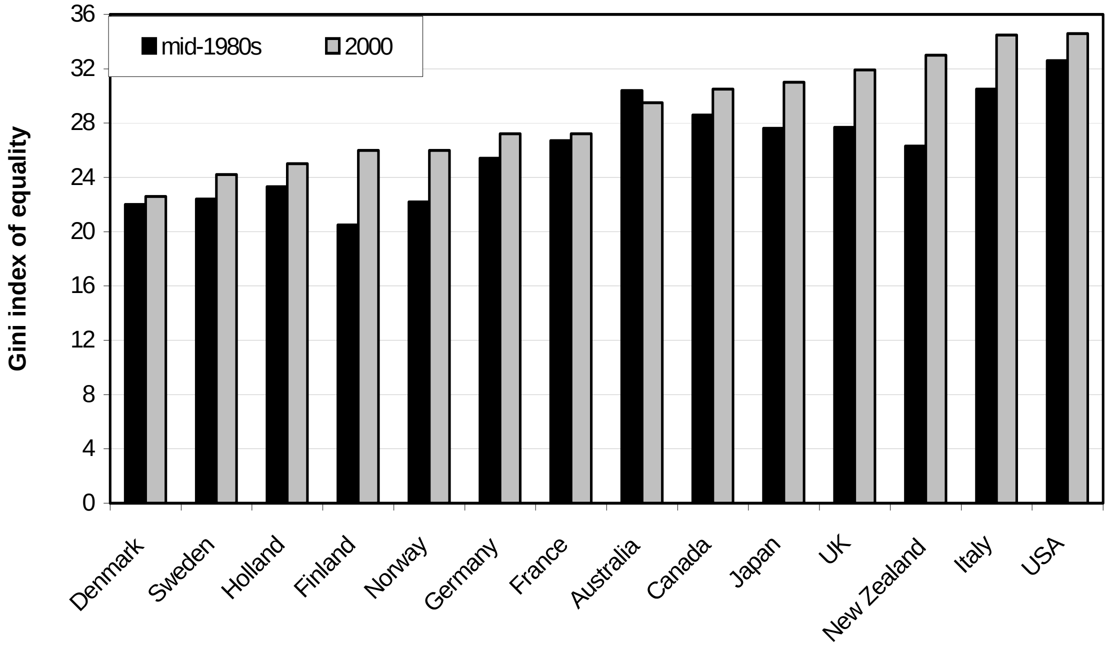
Source: OECD 2005a and 2007g. Data on 19 countries from 2000 (latest available)
Note: Ratio means the ratio of the income shares of top and bottom 30%

Table 3: Gini Coefficient, pre- and post-government measures, 1980s

	Market-determined Gini		**Post-Government measures**		**Impact of Government**	
	Ranking	Gini	Ranking	Gini	Ranking	Gini
Norway	**1**	**0.29**	**3**	**0.22**	**13**	**-0.07**
Denmark	**2**	**0.30**	**2**	**0.22**	**11**	**-0.08**
Finland	3	0.31	1	0.20	6	-0.10
Japan	**4**	**0.31**	**9**	**0.28**	**15**	**-0.03**
Sweden	5	0.35	4	0.22	3	-0.12
Germany	6	0.36	6	0.25	5	-0.11
New Zealand	7	0.36	7	0.26	7	-0.10
Canada	8	0.37	11	0.29	10	-0.08
Netherlands	9	0.37	5	0.23	1	-0.14
USA	**10**	**0.38**	**14**	**0.33**	**14**	**-0.05**
Australia	11	0.39	12	0.30	9	-0.09
UK	12	0.39	10	0.28	4	-0.11
France	13	0.39	8	0.27	2	-0.12
Italy	14	0.39	13	0.31	8	-0.09
Greece	15	0.40	15	0.33	12	-0.08

Source: OECD 2005a
Note: This is data from mid-1980s, based on OECD survey of working age households

Figure 7: Denmark and Sweden Don't Sacrifice Much Equality to Gain Efficiency



Source: OECD 2007a.
Note: Working age population, disposable income

Figure 8a: The Most Egalitarian Have Biggest Loss of Market Equality, 1985-2000

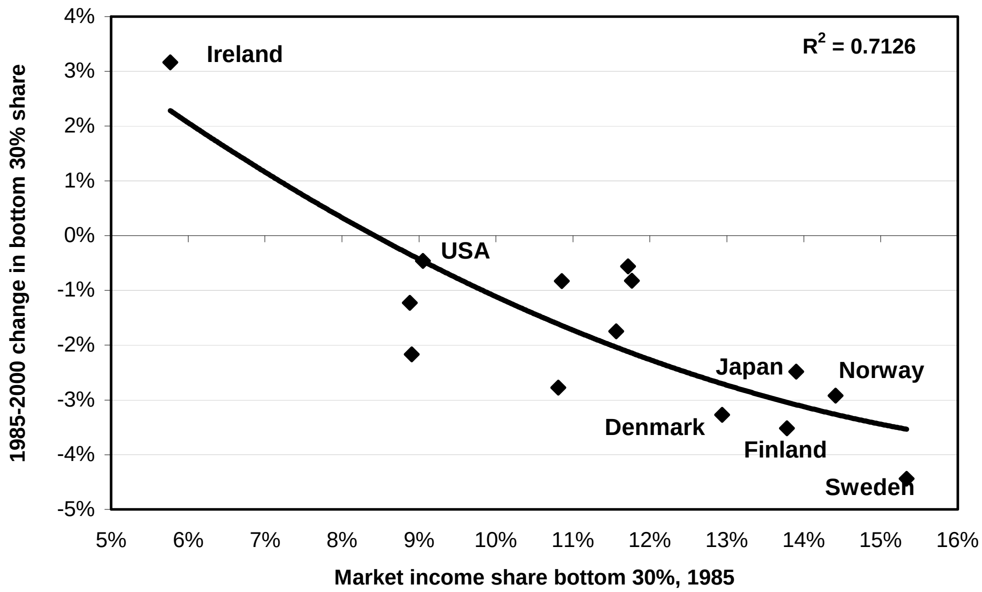
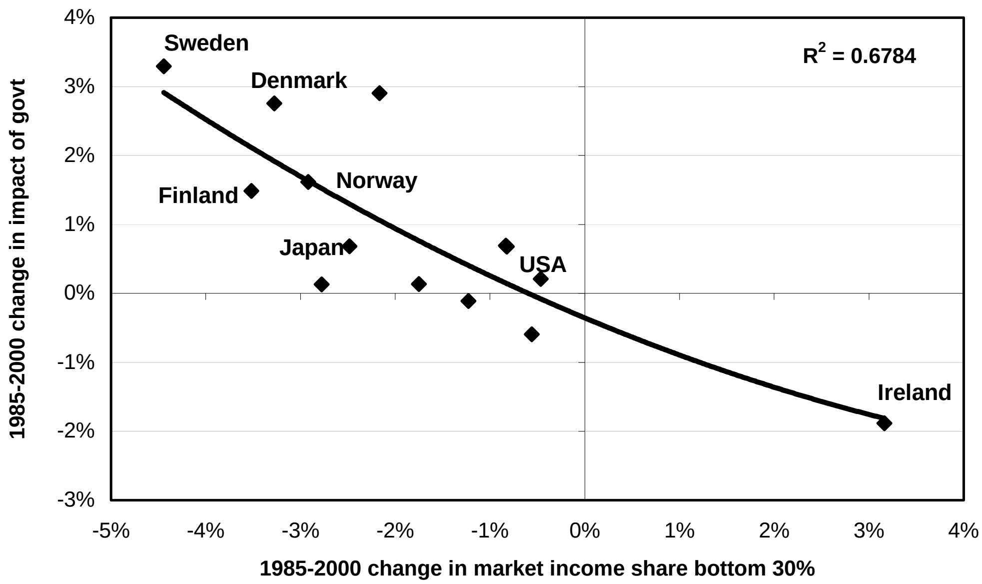
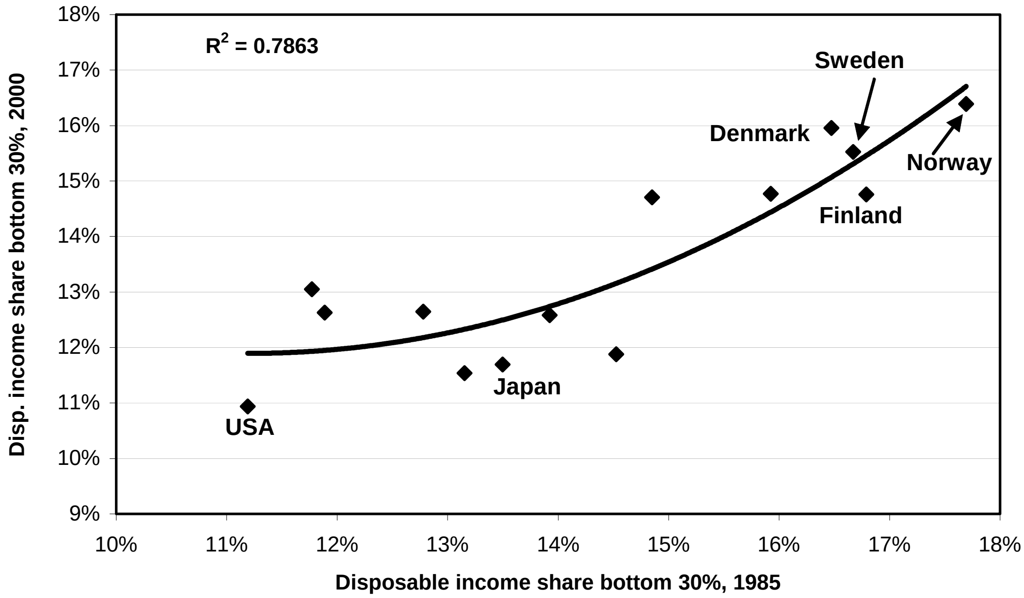


Figure 8b Biggest Losers in Market Equality Do The Biggest Gov't Remedies



Source: OECD 2005a and 2007g. Data on 14 countries

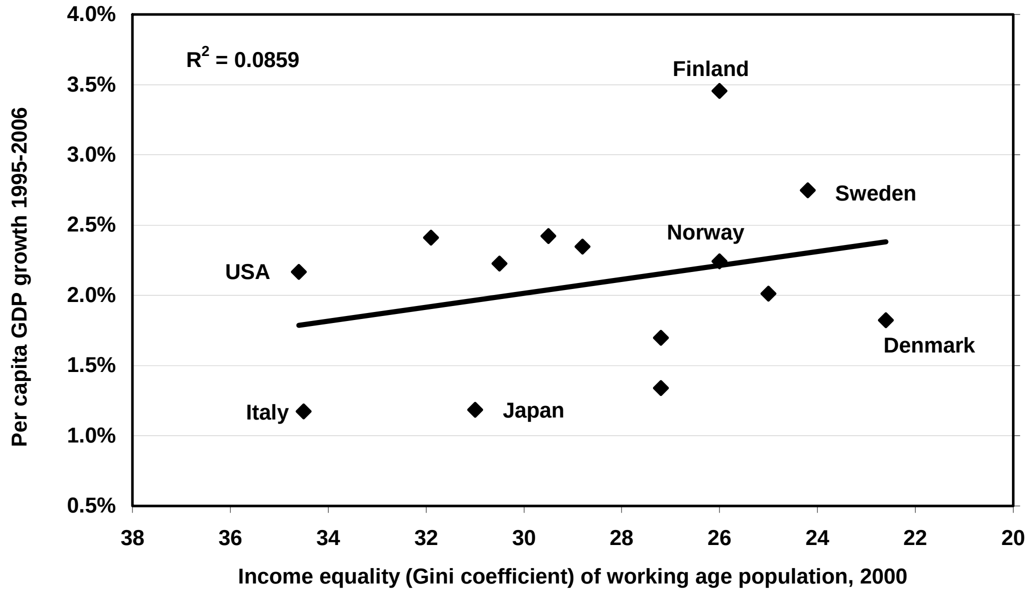
Figure 8c Hence, The Most Egalitarian in 1985 Are Still Most Egalitarian in 2000



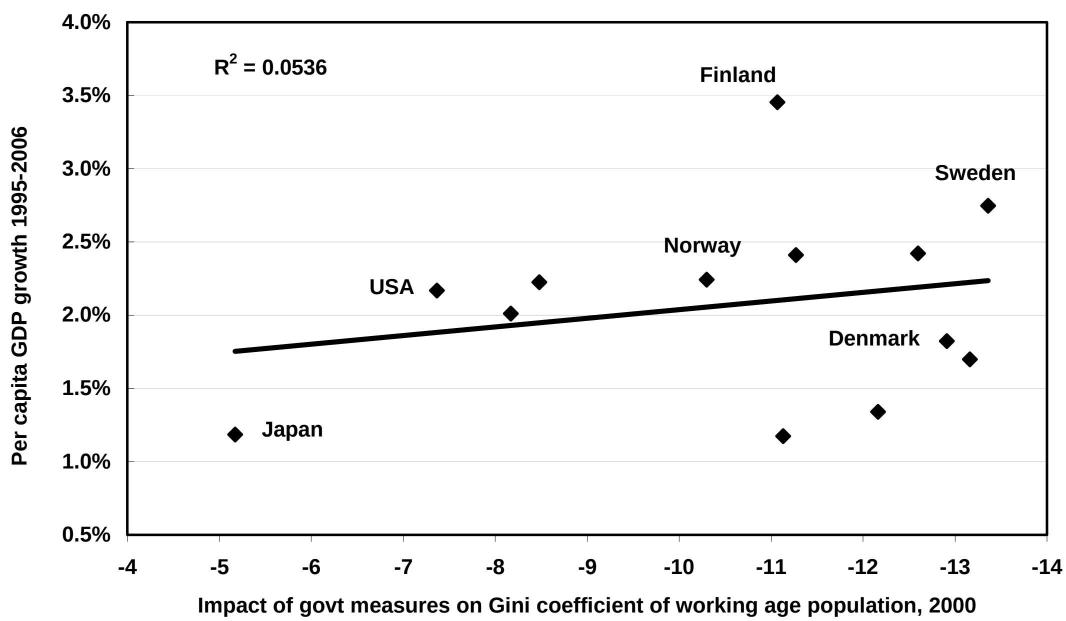
Source: OECD 2005 and 2007g. Data on 14 countries

Figure 9: Equality and Growth: No Trade-Off

A. Post-Govt Equality and Growth

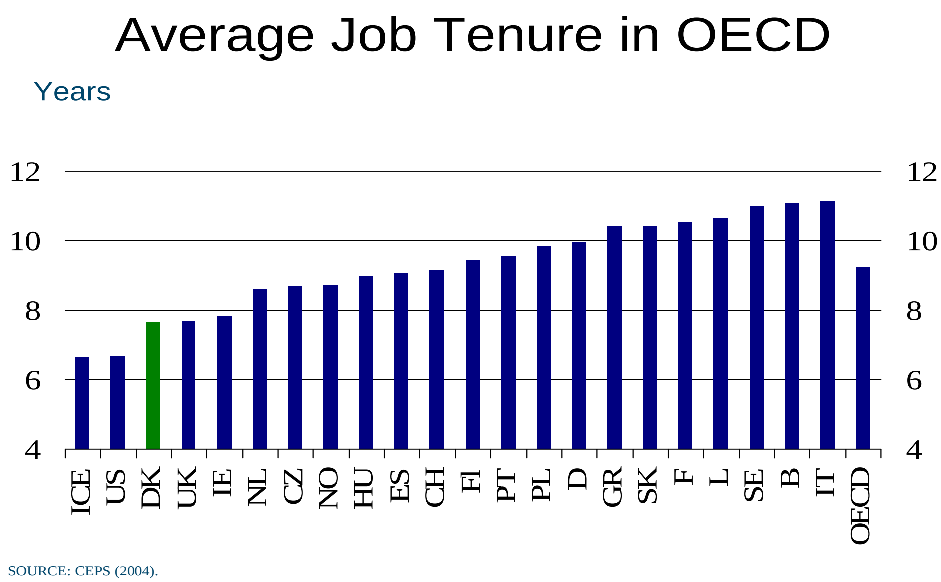


B. Government Redistribution and Growth



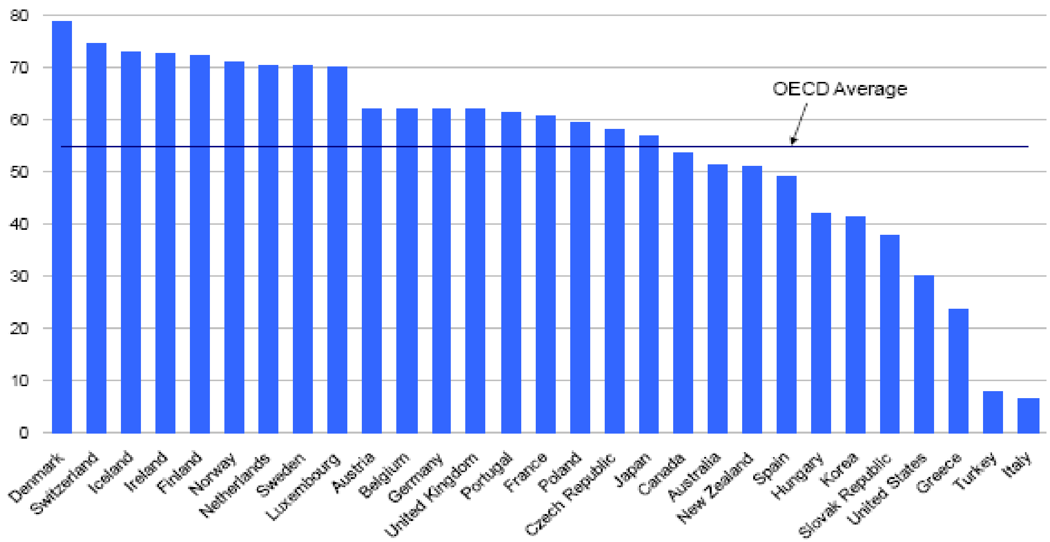
Source: Groningen Growth and Development Centre and Table 2

Figure 10: Average Job Tenure in OECD



Source: PowerPoint provided to author by professors at University of Copenhagen

Figure 11: Unemployment Insurance: Replacement Rates for Lost Income



a. After tax and including unemployment benefits, social assistance, family and housing benefits. Unweighted averages over 60 months of unemployment, for earnings levels of 67% and 100% of average earnings and four family types (single persons, lone parents, one-earner couples with and without children).

Source: OECD

Table 4: Danish Unemployment Insurance Replaces Most of Lost Income for Low Wage Workers

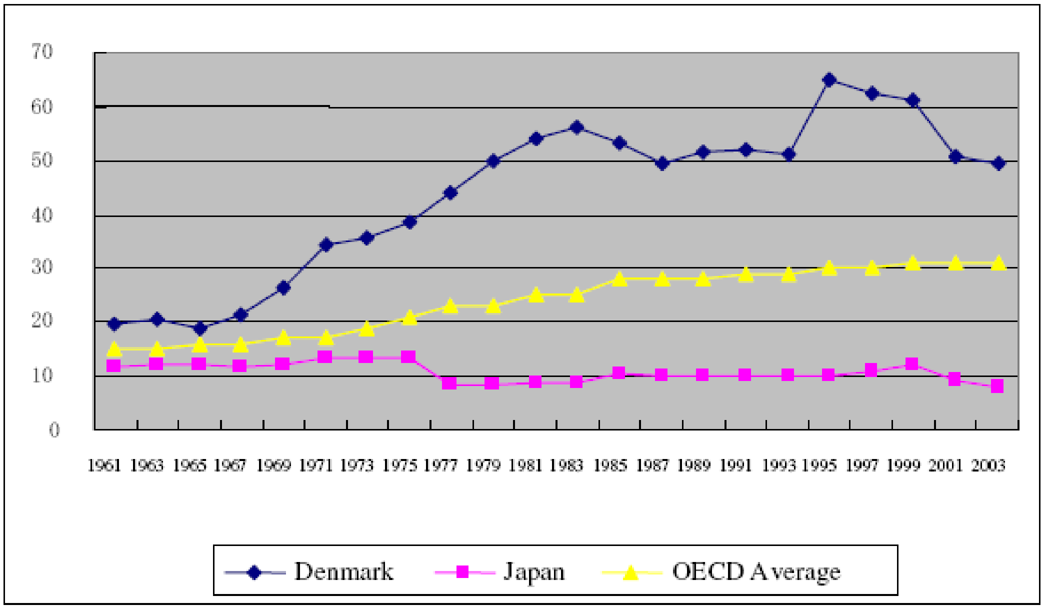
	75%	100%	125%	150%
Denmark	79	61	52	46
GB	25	20	16	14
Germany	59	58	58	58

Table 2: Net replacement rates in % of former salary in Denmark, Great Britain and Germany at varying former income levels (75, 100, 125 and 150% of average yearly earnings) in 1999 (Hansen 2000).

Source: Ilsoe

Figure 12:
Japan Low in OECD on Replacement of Lost Income Due to Unemployment

Figure 5: OECD summary measure of benefit entitlements



Source: OECD, Tax-Benefit Models (2006). Own calculation of OECD average.

Source: Bredgaard and Larsen.
Note: Replacement rate, i.e. unemployment benefits as percentage of former wage. The summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment.

Table 5: Japanese unemployment insurance rewards long job tenure

Unemployment benefit duration (in days, 7 days per week)				
Insured employment (months)	Age of recipient			
	18-29	30-44	45-59	60-64
6 - 12	90	90	90	90
13 - 60	90	90	180	240
61 -120	90	180	210	300
121 - 240	180	210	240	300
241 +	180	210	300	300

Source: OECD 1997

Table 6: Percent of Workers With Ten Years Tenure High in Japan, Continental Europe

Table 1: Average tenure and tenure distribution in selected countries

	Average tenure (years)	Workers with less than 1 year's tenure (%)	Workers with more than 10 year's tenure (%)
Greece	13.6	9.8	52.1
Japan	12.2	8.3	43.2
Italy	12.2	10.8	49.3
France	11.2	15.3	44.2
Germany	10.6	14.3	41.7
Denmark	8.3	20.9	31.5
United Kingdom	8.2	19.1	32.1
United States	6.6	24.5	26.2

Sources: Data for Europe from 2002 based on Eurostat; US data from 1998 based on national sources. Data for Japan from 2000, cf.Ono 2006.

Source: Bredgaard and Larsen

Figure 13:
Denmark, Sweden Spend a Lot on Active Labor Market Policies; not Japan

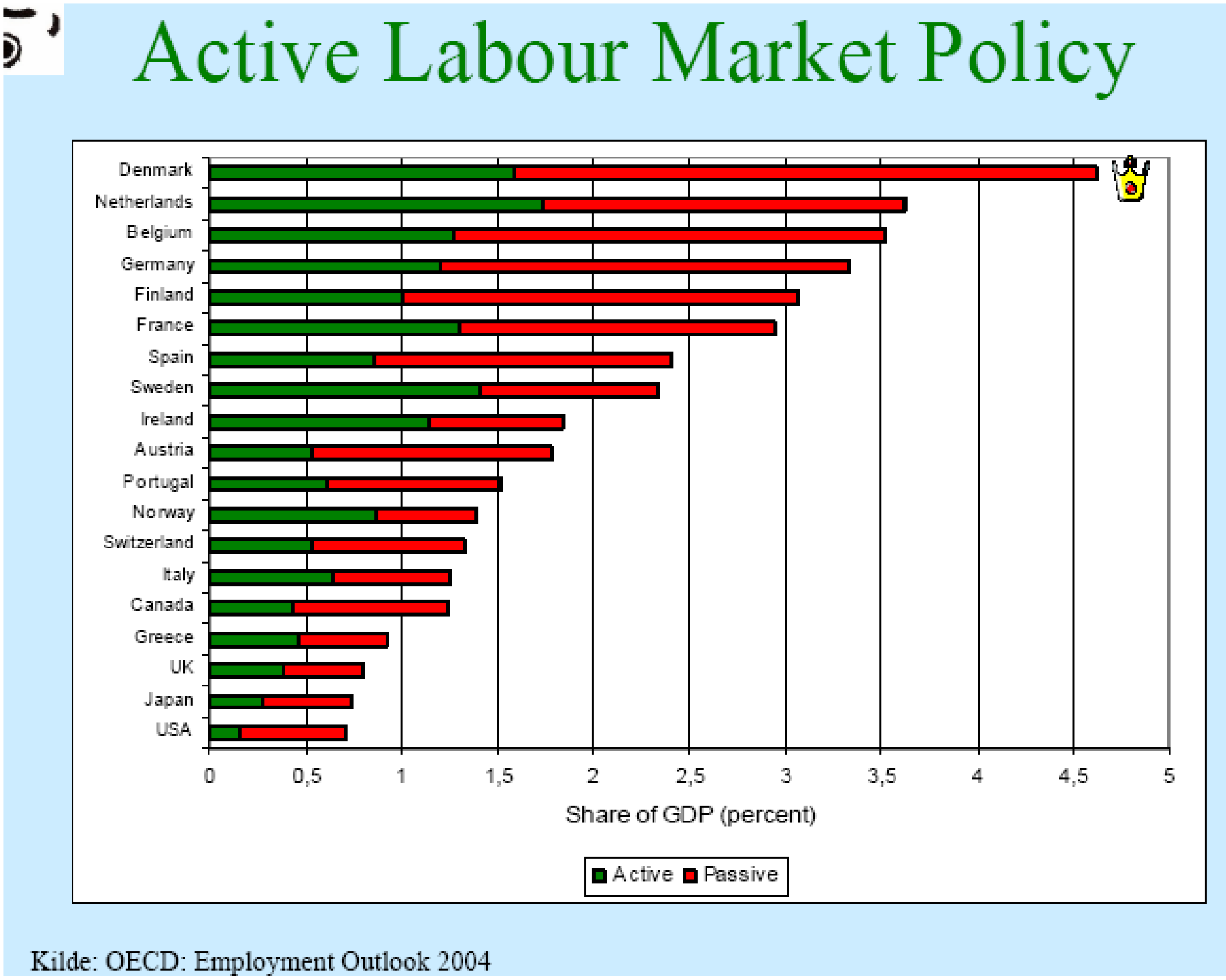
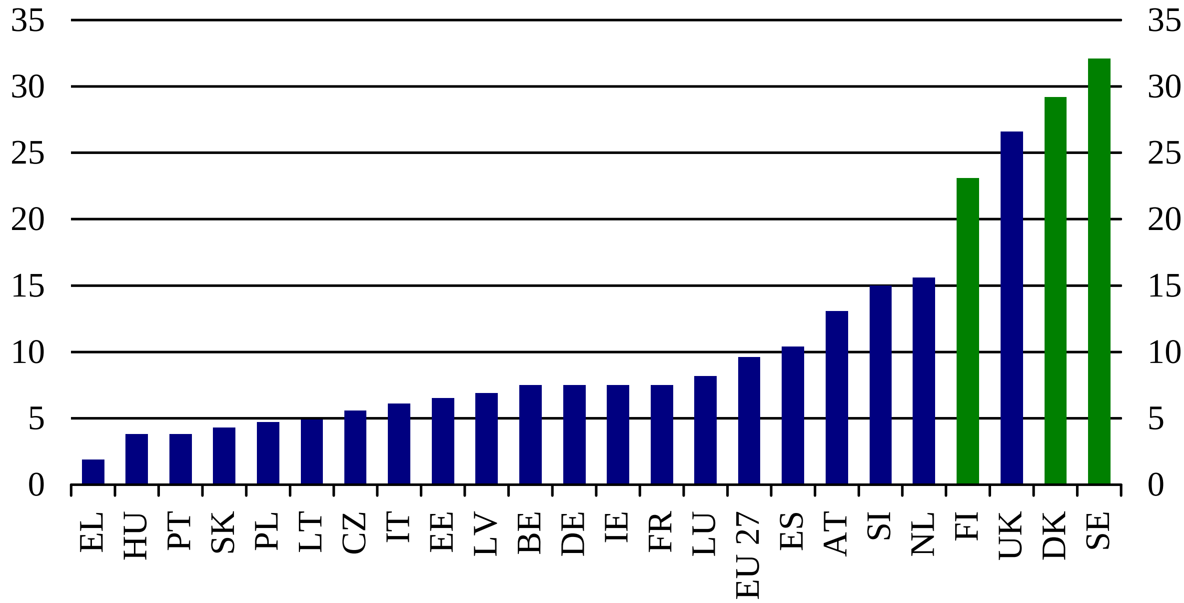


Figure 14: Lifelong Learning Enables Nordics to Upgrade Their Job Skills

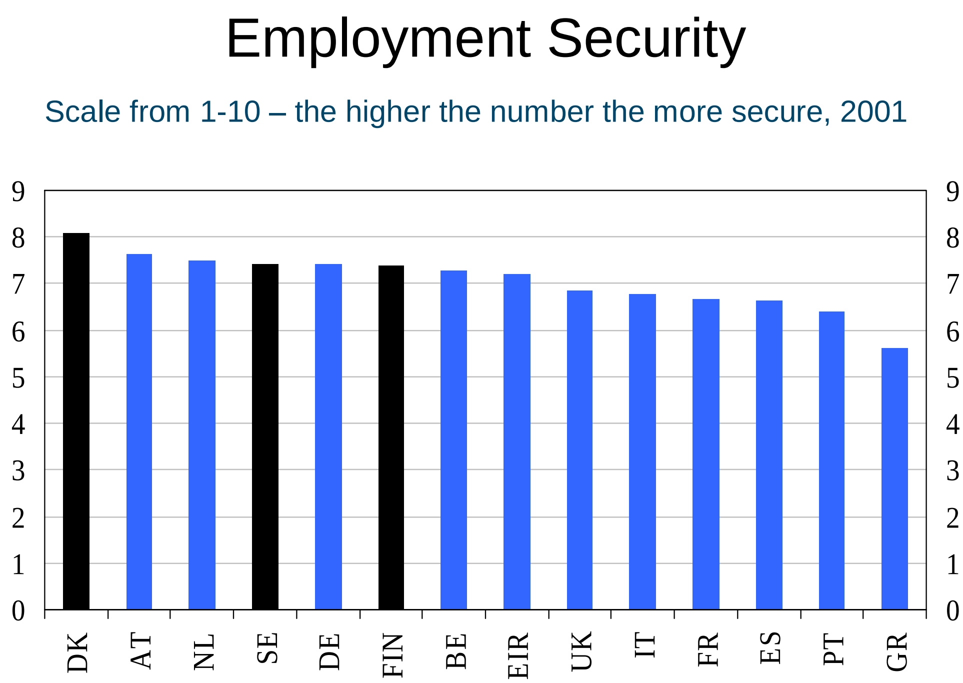
Percentage of the adult population aged 25-64 participating in education and training, 2006



Source: EU Labour Force Survey, cited in PowerPoint given to author by professors at the University of Copenhagen

Note: Life-long learning refers to persons aged 25 to 64 who stated that they received education or training in the four weeks preceding the survey whether or not the education was directly relevant to the respondent's current or possible future job.

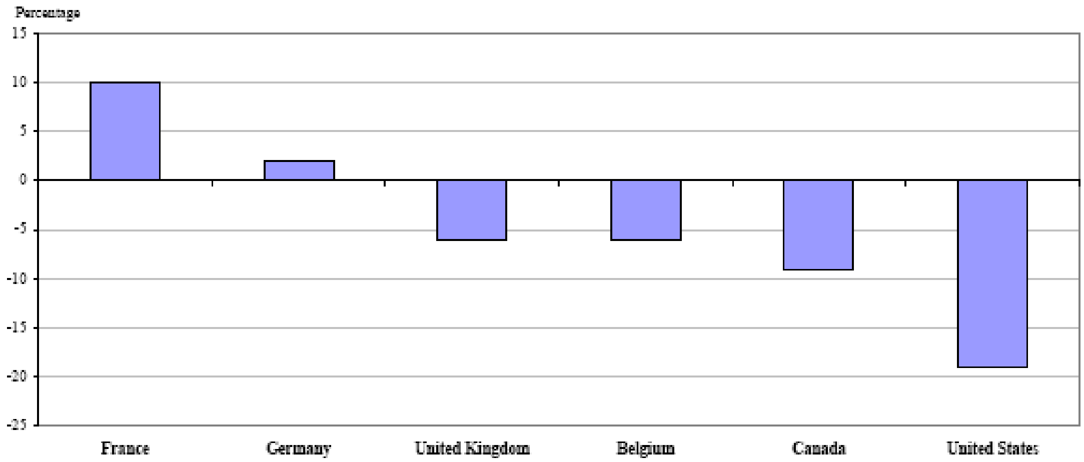
Figure 15: Scandinavian Workers Not Afraid What Will Happen If Lose Their Job



SOURCE: CEPS (2004) and Eurostat.

Figure 16: US Workers Worst Off When Trade Takes Away a Job

Figure III.11. Trade-displaced workers must often accept large pay cuts to get a new job [1]



1. Average wage changes for workers who previously had more than 10 years of job tenure. Refers to total layoffs for Canada, United Kingdom and United States, and to mass layoffs only for Belgium, France and Germany.

Source: OECD *Employment Outlook* 2005.

Source: OECD 2007b

Figure 17: High Employment Rate in Scandinavia

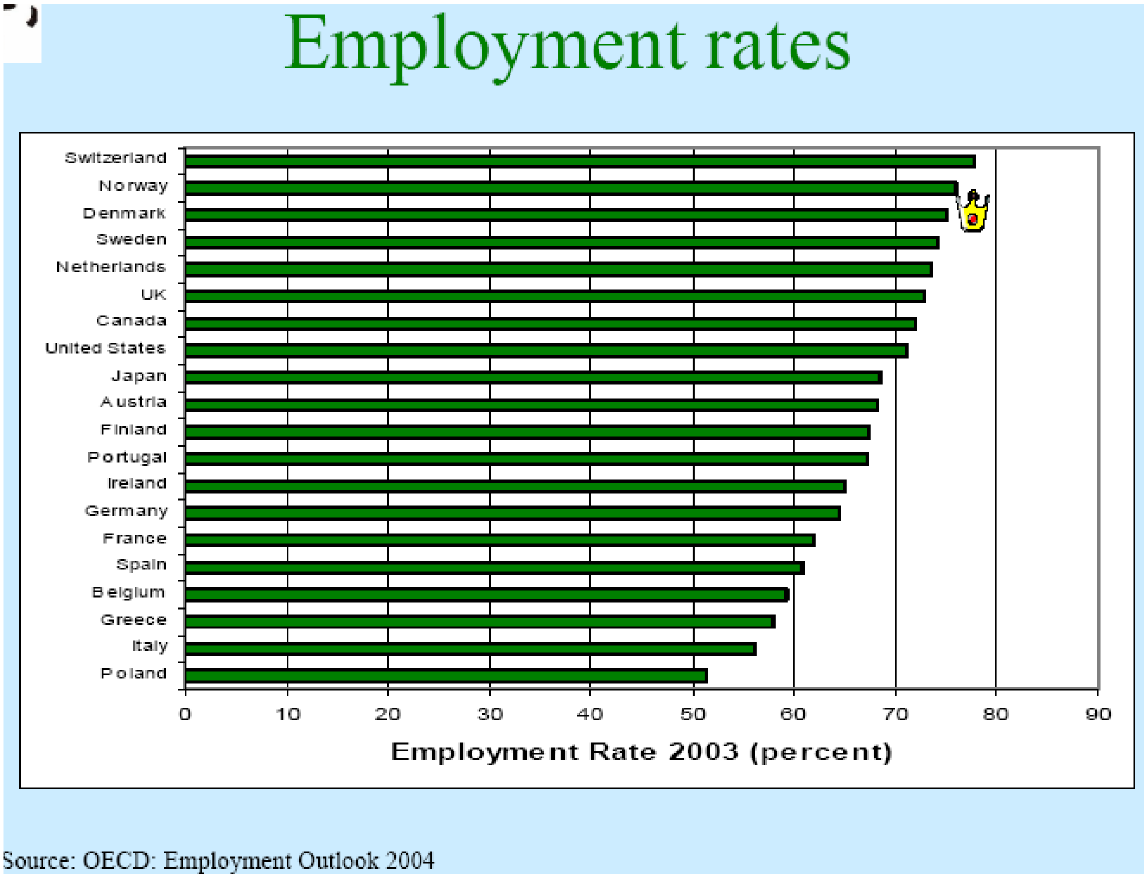


Figure 18a: Job Growth Largely Reflects Demographics

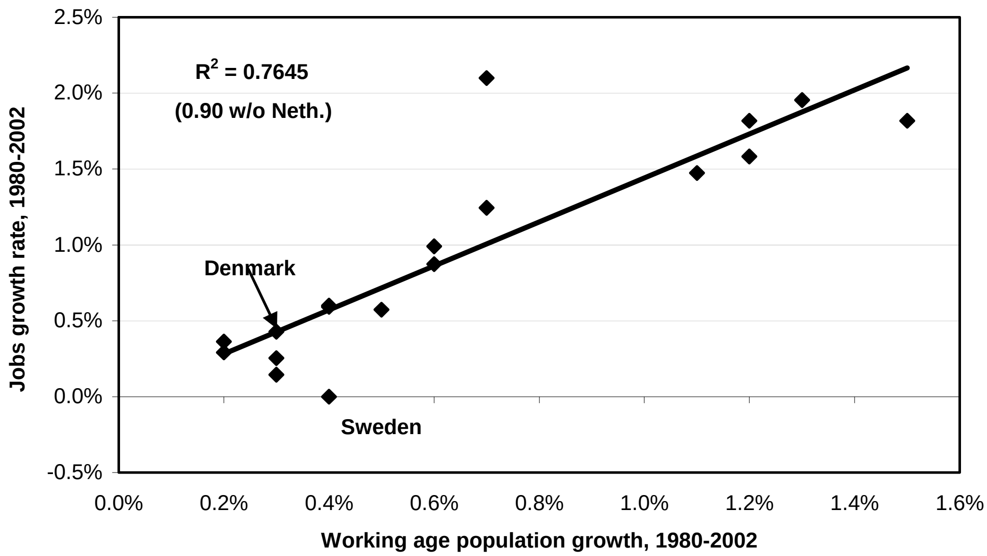
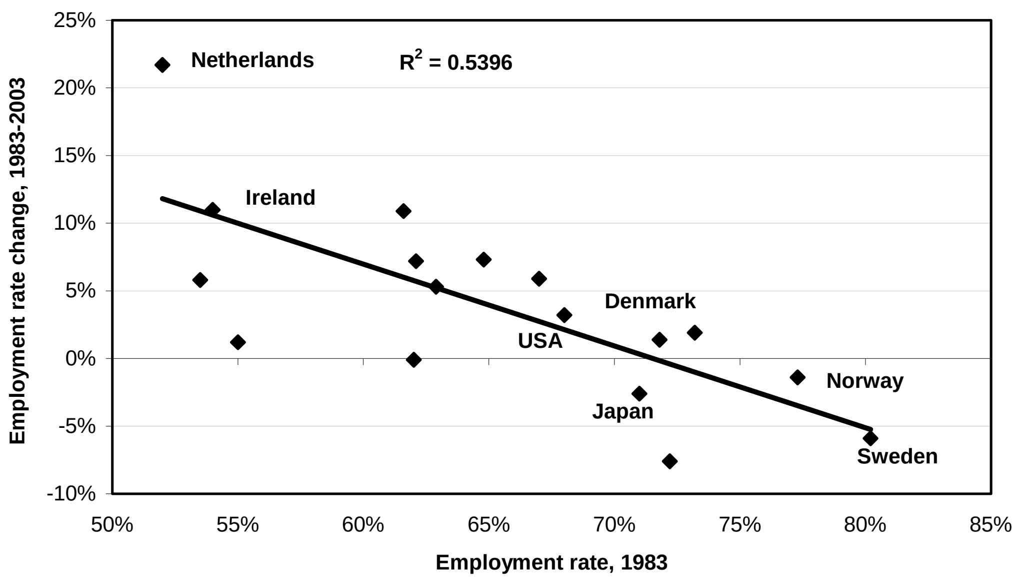
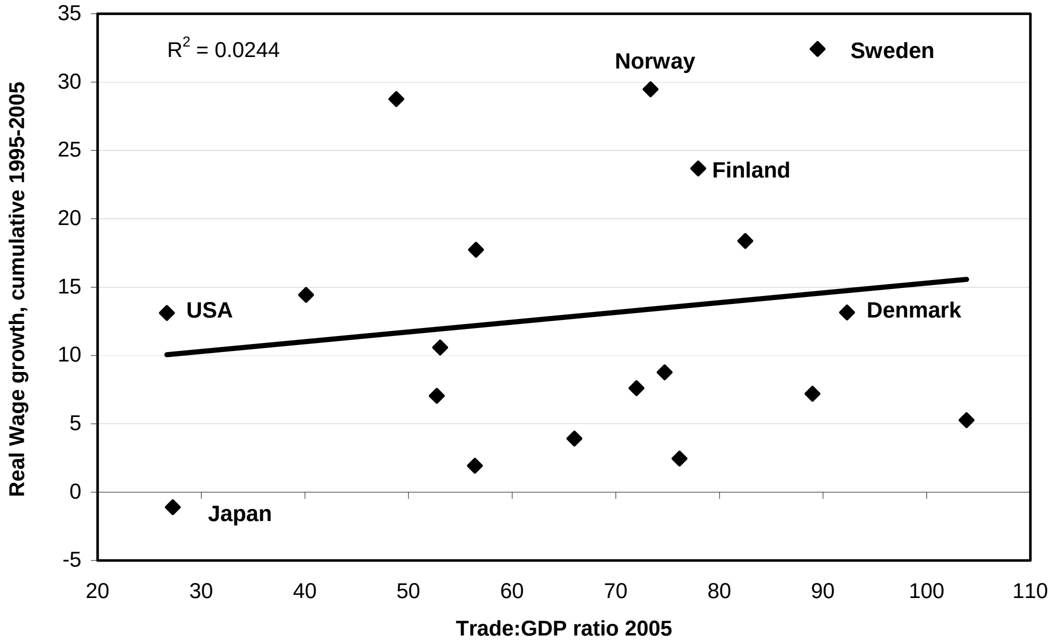


Figure 18b: Regression to the Mean on Employment Rates



Source: Pontusson

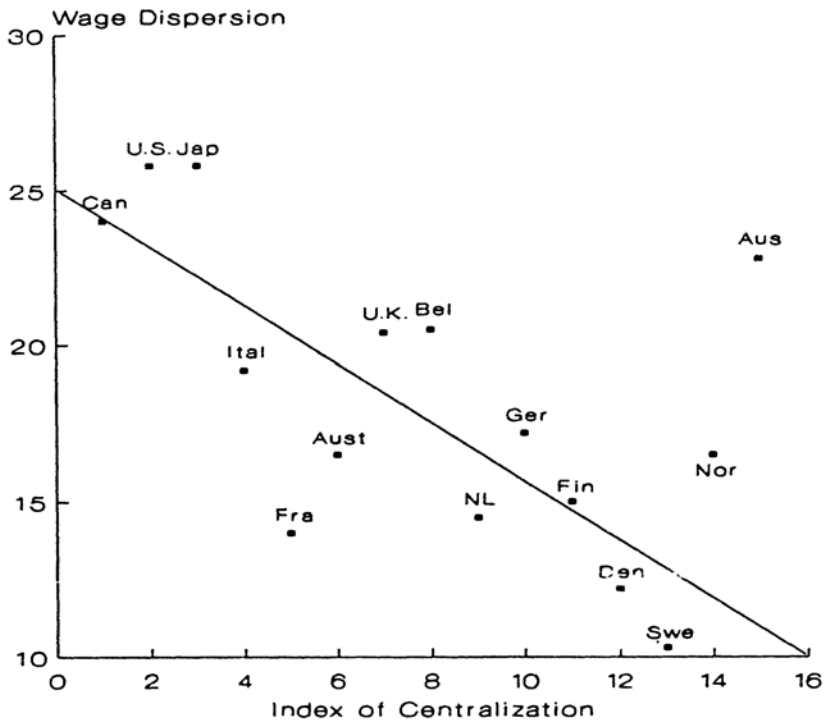
Figure 19: No Race to the Bottom: Nordics Enjoy High Wage Growth



Source: OECD 2007c

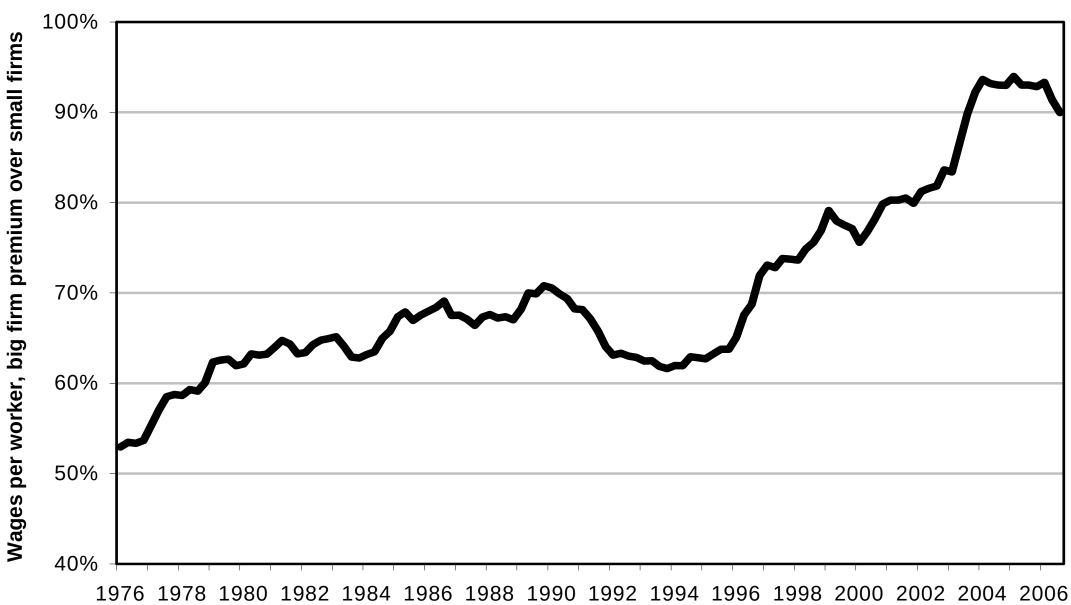
Figure 20: Centralized Wage Bargaining Promotes Wage Equality

Countries, 1973–1986



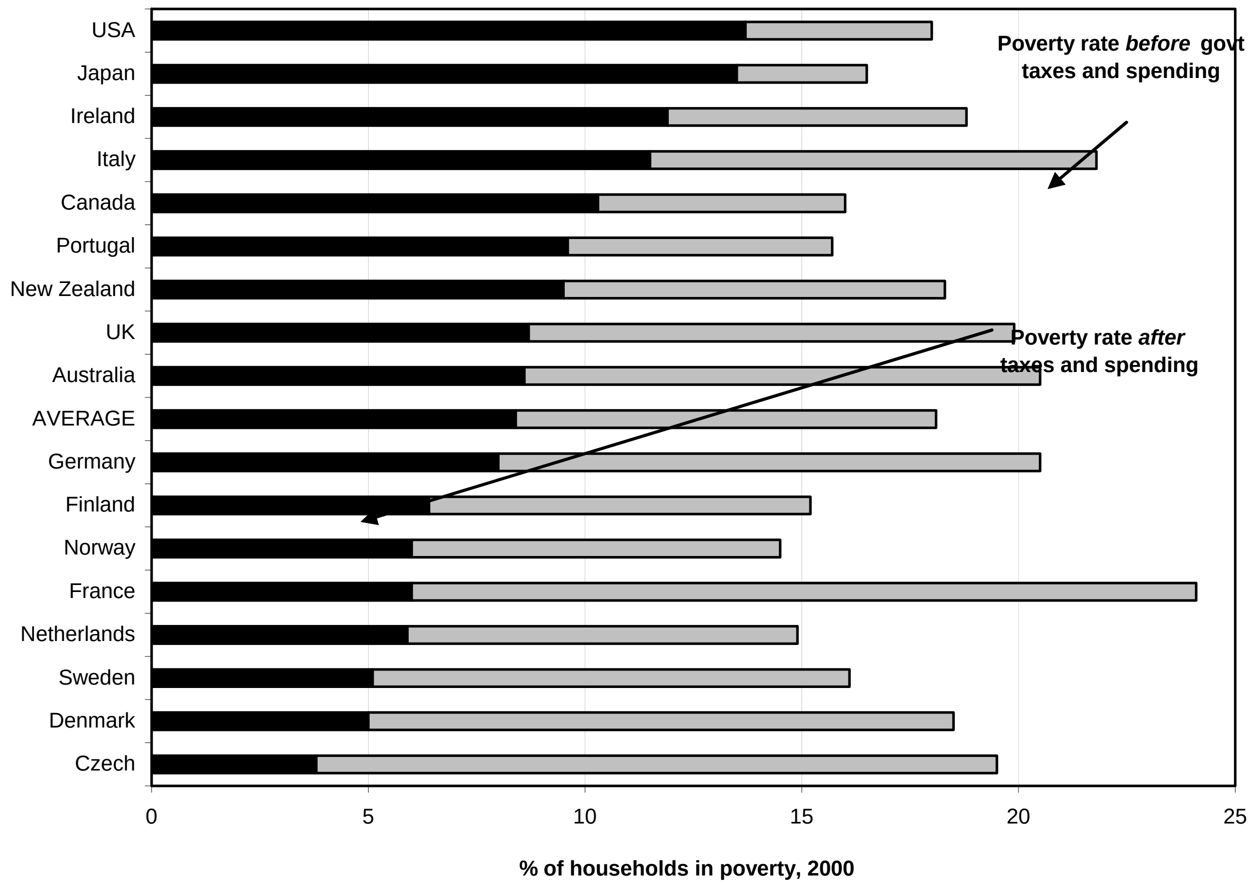
Source: Iversen

Figure 21: Japanese Big Firm Premium Rises As Shunto Weakens



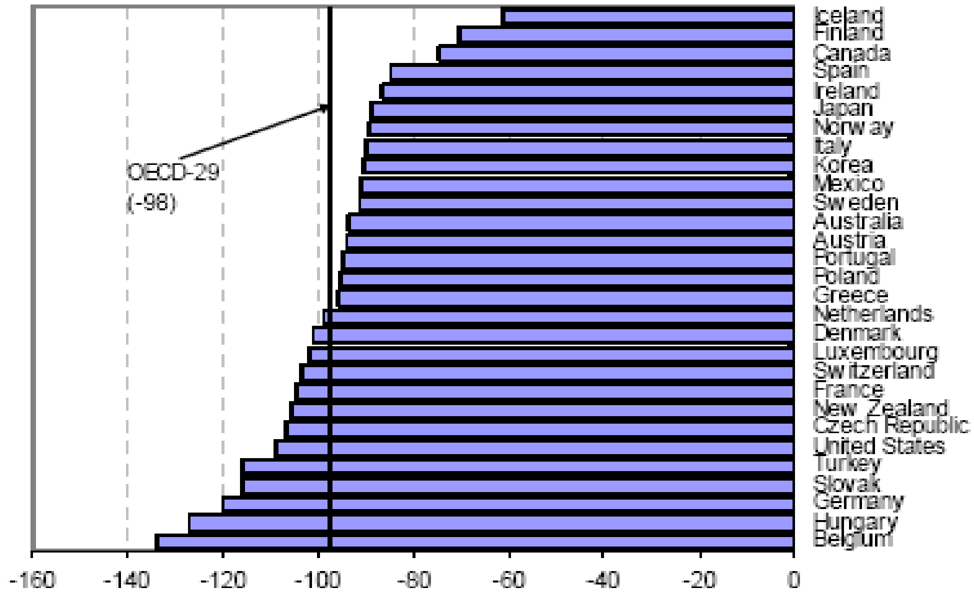
Source: Ministry of Finance. Corporate financial statements

Figure 22: Denmark and Sweden 2nd and 3rd Lowest Poverty Rates in the OECD; USA and Japan the Highest



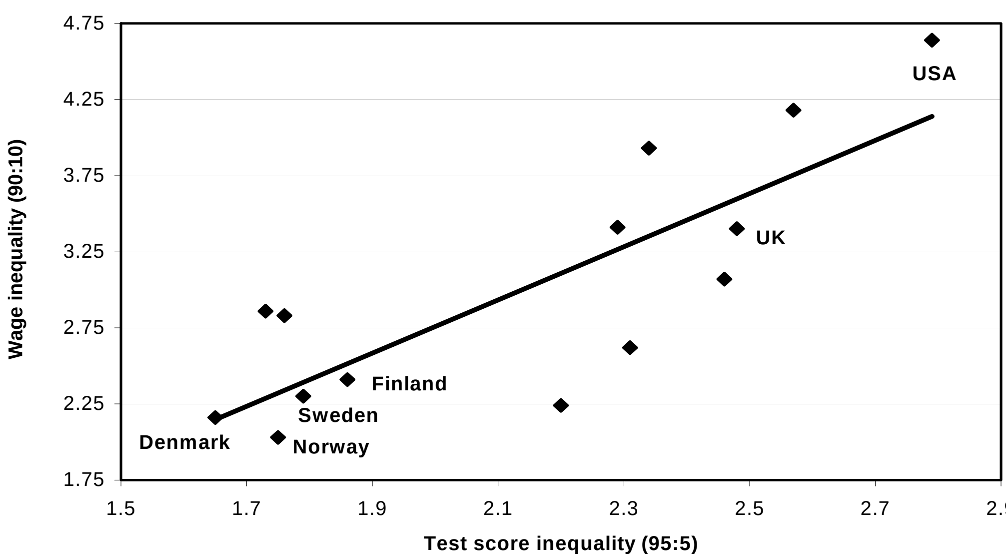
Source: OECD 2007a
Note: Data for year 2000; poverty is defined as household income less than one-half of the median income

Figure 23a
Performance Gap Between Children of High-Status and Low-Status Parents



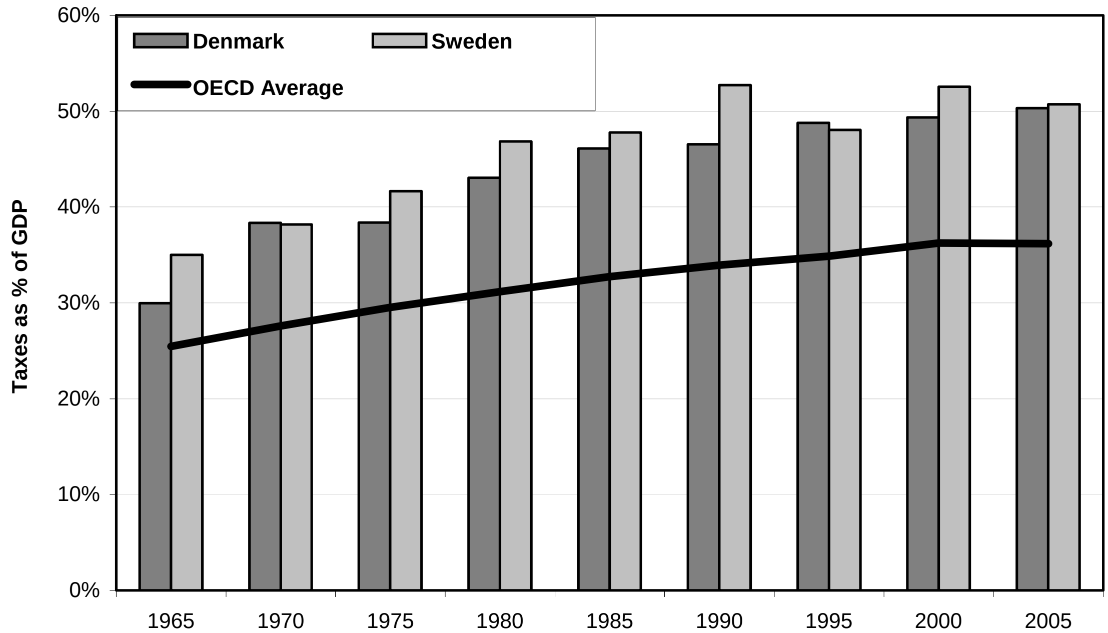
Source: OECD 2007e
Note: The index includes the highest Occupational Status of the parents or guardians, the highest level of education of the parents, an index of the educational resources in the home (e.g. a desk to study at home) and the number of books at home.

Figure 23b: Educational Equality Leads to Income Equality



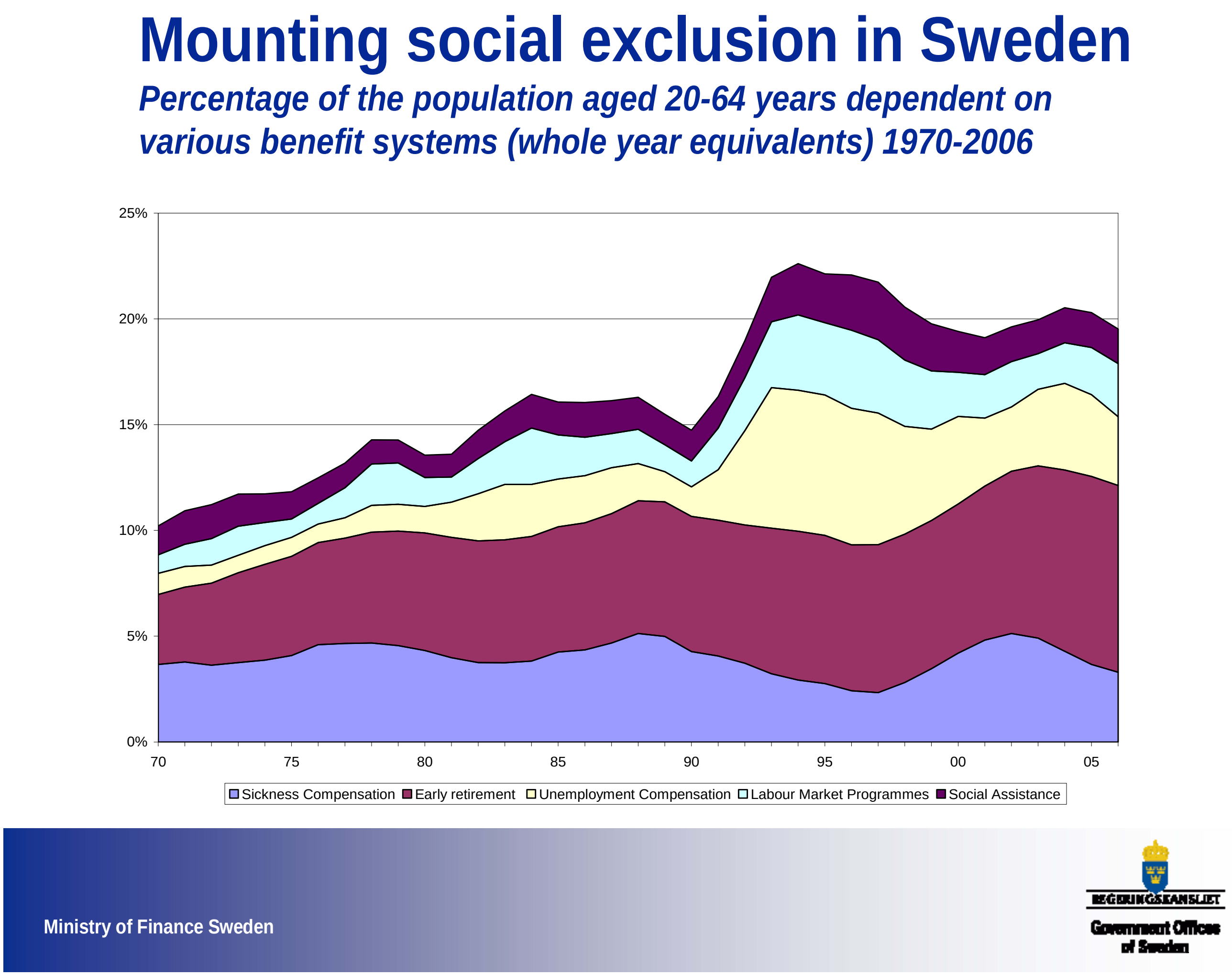
Source: Pontusson
Note: Test score inequality measures the ratio of literacy test scores between the 95th and 5th percentiles for ages 15-65 during the late 1990s. Wage inequality measures the ratio of wages for the 90th and 10th percentiles for full-time employees. Unfortunately, Japan is not in the dataset.

Figure 24: Scandinavian Taxes Rose to Half of GDP



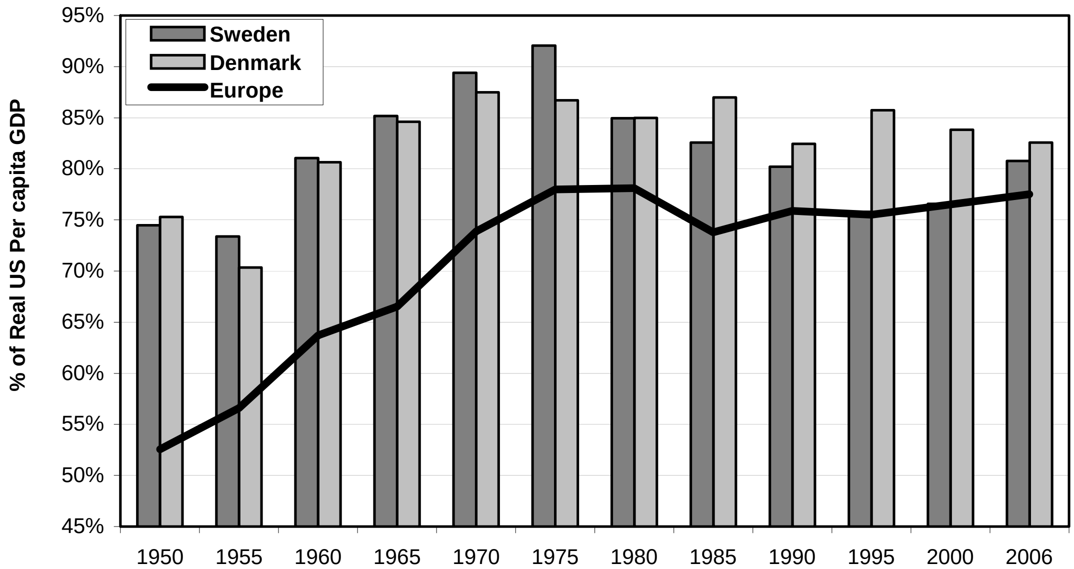
Source: OECD 2007d

Figure 25
Too Many Working Age People On Sick Leave, Early Retirement, Etc.



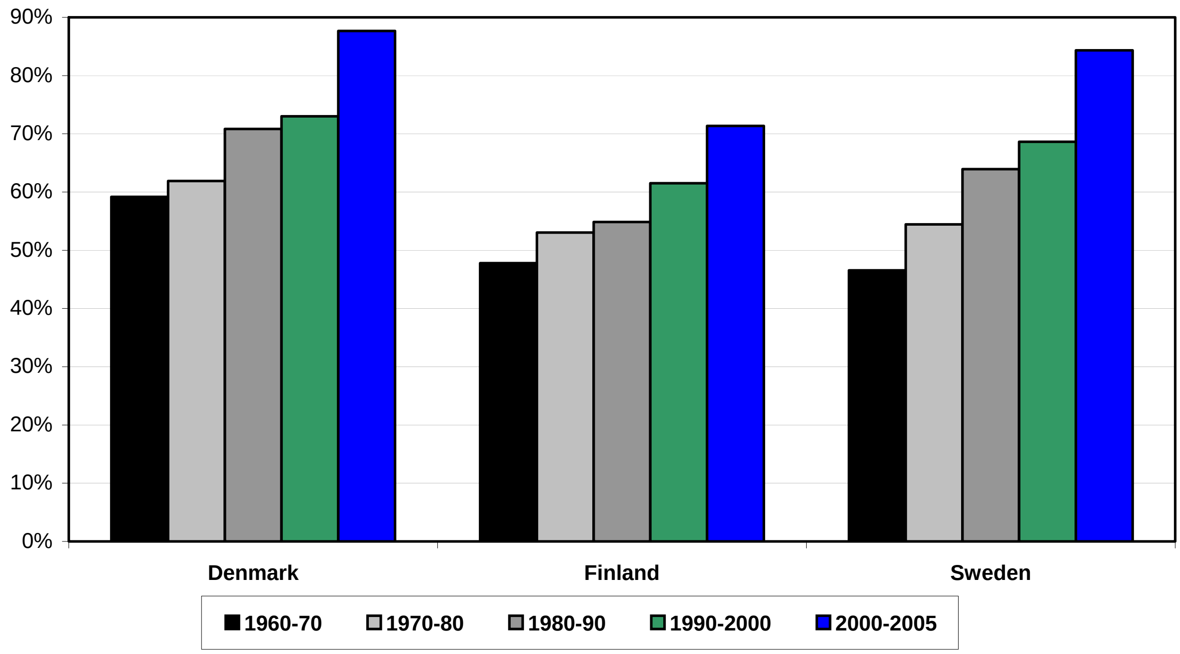
Source: Ministry of Finance, Sweden

Figure 26 Per capita GDP--% of US level



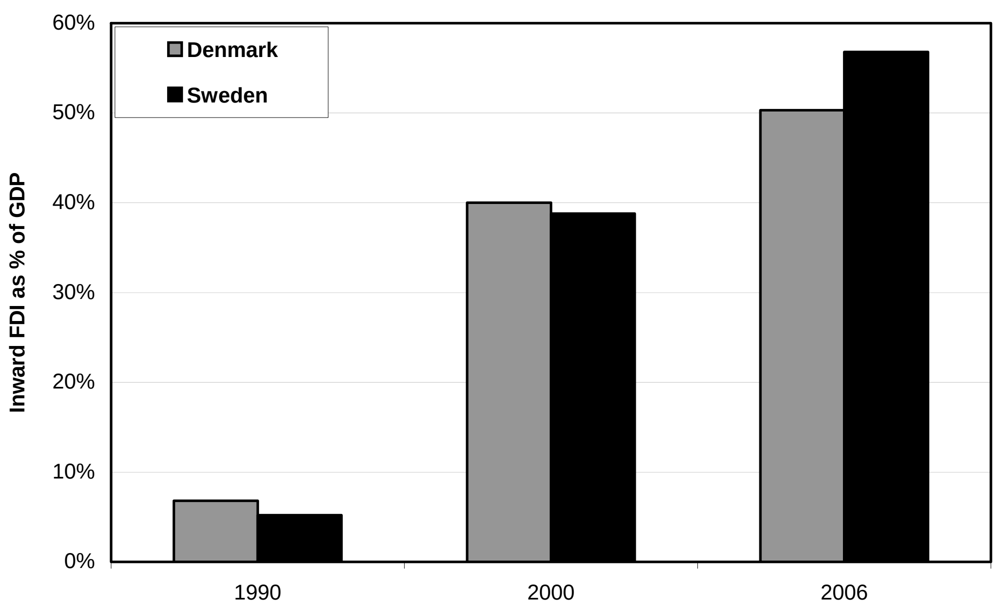
Source: Groningen Growth and Development Centre
Note: Based on Purchasing Power Parity comparisons of real GDP

Figure 27a Nordics Increase Trade to Promote Growth



Source: World Bank website

Figure 27b Inward Foreign Direct Investment Soars



Source: UNCTAD

Figure 28 Japan Exports Too Little, Imports Too Little

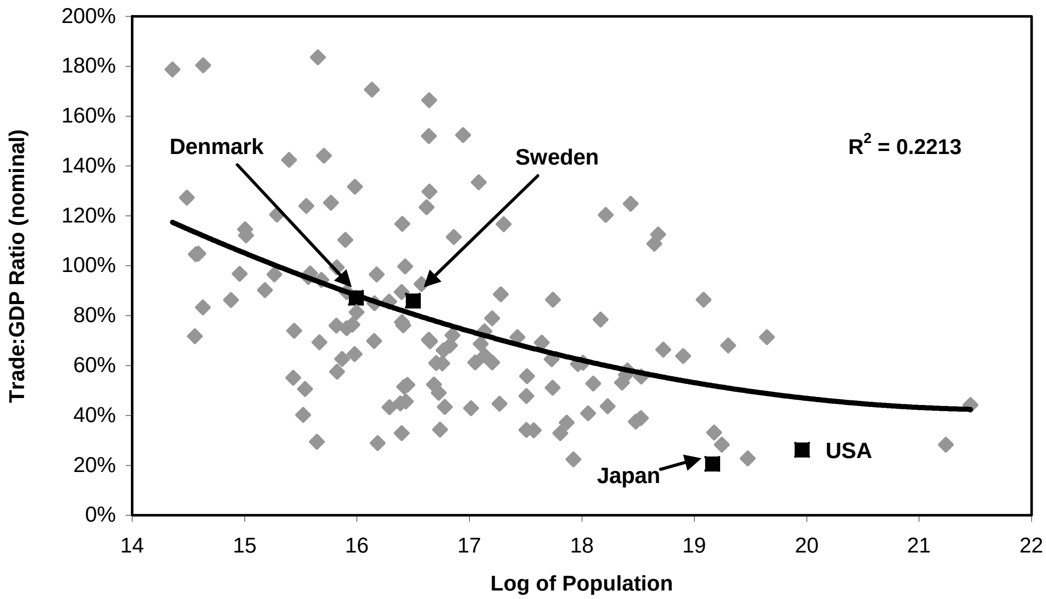
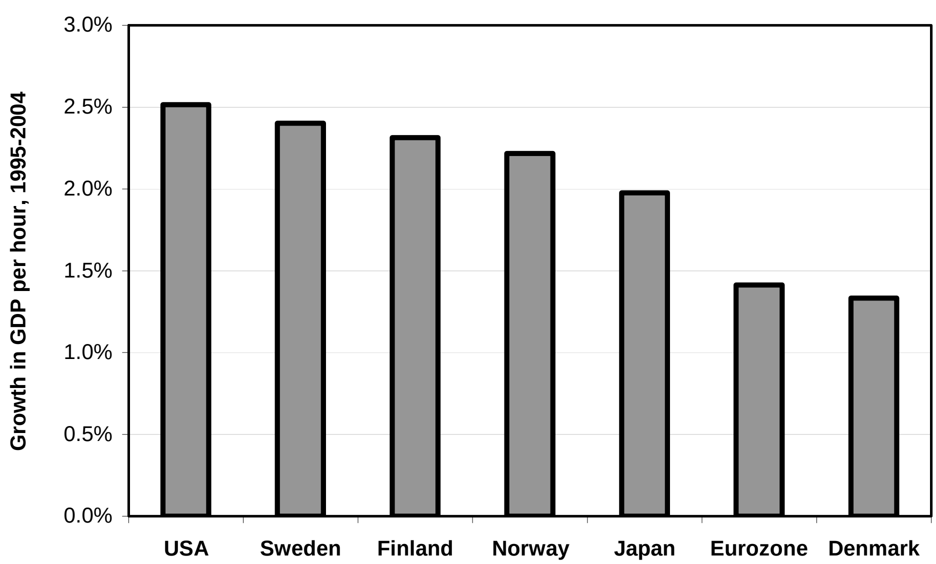
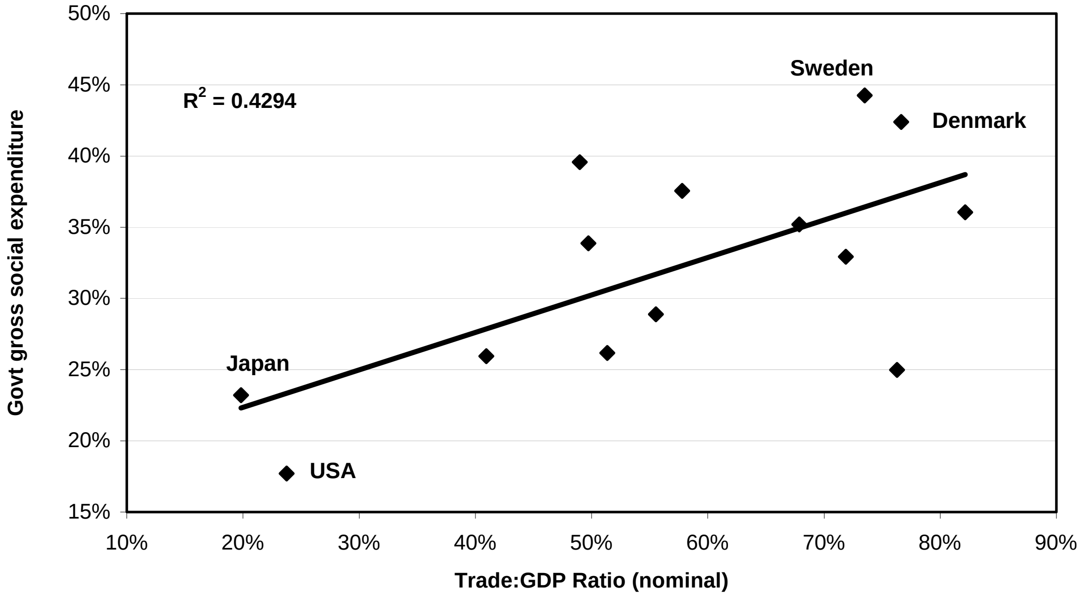


Figure 29 Nordics, Except Denmark, Excel in Growth in GDP Per Hour



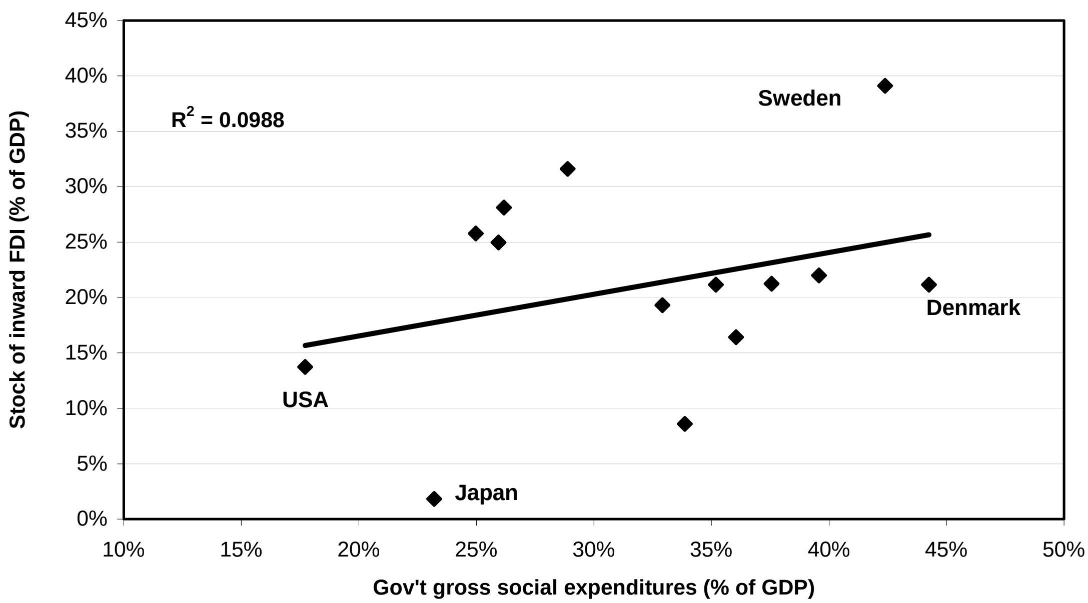
Source: OECD 2007h

Figure 30a Countries That Trade More Spend More on The Social Safety Net



Source: OECD (2005b) and World Bank
Note: R-squared to 0.429 means that 43% of the variation among countries in social spending can be explained by their trade openness.

Figure 30b FDI Doesn't Flee Countries That Spend on Social Welfare



Source: OECD (2005c)
Note: Although the chart appears to indicate that countries with higher social spending actually attract FDI, the correlation is not statistically significant, particularly if we remove outlier Japan.

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