

SPECIAL REPORT

Northern lights

The Nordic countries are reinventing their model of capitalism, says Adrian Wooldridge

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THIRTY YEARS AGO Margaret Thatcher turned Britain into the world's leading centre of "thinking the unthinkable". Today that distinction has passed to Sweden. The streets of Stockholm are awash with the blood of sacred cows. The think-tanks are brimful of new ideas. The erstwhile champion of the "third way" is now pursuing a far more interesting brand of politics.

Sweden has reduced public spending as a proportion of GDP from 67% in 1993 to 49% today. It could soon have a smaller state than Britain. It has also cut the top marginal tax rate by 27 percentage points since 1983, to 57%, and scrapped a mare's nest of taxes on property, gifts, wealth and inheritance. This year it is cutting the corporate-tax rate from 26.3% to 22%.

Sweden has also donned the golden straitjacket of fiscal orthodoxy with its pledge to produce a fiscal surplus over the economic cycle. Its public debt fell from 70% of GDP in 1993 to 37% in 2010, and its budget moved from an 11% deficit to a surplus of 0.3% over the same period. This allowed a country with a small, open economy to recover quickly from the financial storm of 2007-08. Sweden has also put its pension system on a sound foundation, replacing a defined-benefit system with a defined-contribution one and making automatic adjustments for longer life expectancy.

Most daringly, it has introduced a universal system of school vouchers and invited private schools to compete with public ones. Private companies also vie with each other to provide state-funded health services and care for the elderly. Anders Aslund, a Swedish economist who lives in America, hopes that Sweden is pioneering "a new conservative model"; Brian Palmer, an American anthropologist

who lives in Sweden, worries that it is turning into “the United States of Swedeamerica”.

There can be no doubt that Sweden’s quiet revolution has brought about a dramatic change in its economic performance. The two decades from 1970 were a period of decline: the country was demoted from being the world’s fourth-richest in 1970 to 14th-richest in 1993, when the average Swede was poorer than the average Briton or Italian. The two decades from 1990 were a period of recovery: GDP growth between 1993 and 2010 averaged 2.7% a year and productivity 2.1% a year, compared with 1.9% and 1% respectively for the main 15 EU countries.



For most of the 20th century Sweden prided itself on offering what Marquis Childs called, in his 1936 book of that title, a “Middle Way” between capitalism and socialism. Global companies such as Volvo and Ericsson generated wealth while enlightened bureaucrats built the *Folkhemmet* or “People’s Home”. As the decades rolled by, the middle way veered left. The government kept growing: public spending as a share of GDP nearly doubled from 1960 to 1980 and peaked at 67% in 1993. Taxes kept rising. The Social Democrats (who ruled Sweden for 44 uninterrupted years from 1932 to 1976 and for 21 out of the 24 years from 1982 to 2006) kept squeezing business. “The era of neo-capitalism is drawing to an end,” said Olof Palme, the party’s leader, in 1974. “It is some kind of socialism that is the key to the future.”

The other Nordic countries have been moving in the same direction, if more slowly. Denmark has one of the most liberal labour markets in Europe. It also allows parents to send children to private schools at public expense and make up the difference in cost with their own money. Finland is harnessing the skills of venture capitalists and angel investors to promote innovation and entrepreneurship. Oil-rich Norway is a partial exception to this pattern, but even there the government is preparing for its post-oil future.

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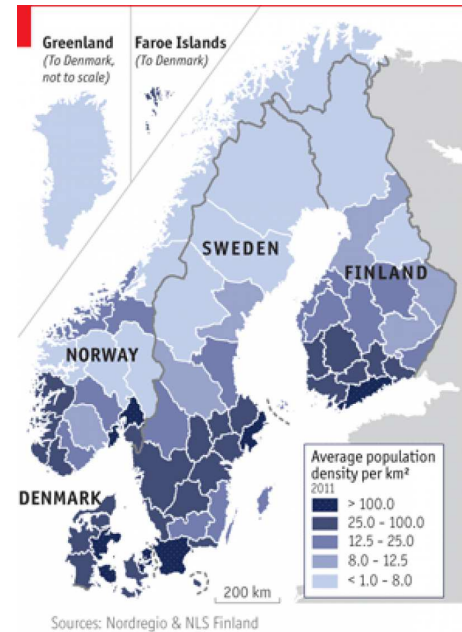
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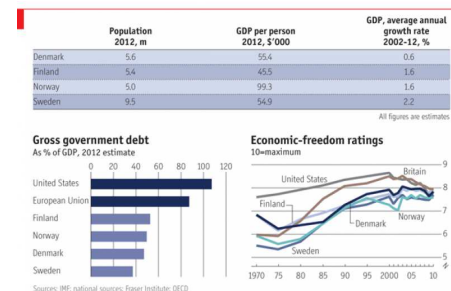
This is not to say that the Nordics are shredding their old model. They



continue to pride themselves on the generosity of their welfare states. About 30% of their labour force works in the public sector, twice the average in the Organisation for Economic Development and Co-operation, a rich-country think-tank. They continue to believe in combining open economies with public investment in human capital. But the new Nordic model begins with the individual rather than the state. It begins with fiscal responsibility rather than pump-priming: all four Nordic countries have AAA ratings and debt loads significantly below the euro-zone average. It begins with choice and competition rather than paternalism and planning. The economic-freedom index of the Fraser Institute, a Canadian think-tank, shows Sweden and Finland catching up with the United States (see chart). The leftward lurch has been reversed: rather than extending the state into the market, the Nordics are extending the market into the state.

Why are the Nordic countries doing this? The obvious answer is that they have reached the limits of big government. "The welfare state we have is excellent in most ways," says Gunnar Viby Mogensen, a Danish historian. "We only have this little problem. We can't afford it." The economic storms that shook all the Nordic countries in the early 1990s provided a foretaste of what would happen if they failed to get their affairs in order.

There are two less obvious reasons. The old Nordic model depended on the ability of a cadre of big companies to generate enough money to support the state, but these companies are being slimmed by global competition. The old model also depended on people's willingness to accept direction from above, but Nordic



populations are becoming more demanding.

Small is powerful

The Nordic countries have a collective population of only 26m. Finland is the only one of them that is a member of both the European Union and the euro area.

Sweden is in the EU but outside the euro and has a freely floating currency.

Denmark, too, is in the EU and outside the euro area but pegs its currency to the euro. Norway has remained outside the EU.

But there are compelling reasons for paying attention to these small countries on the edge of Europe. The first is that they have reached the future first. They are grappling with problems that other countries too will have to deal with in due course, such as what to do when you reach the limits of big government and how to organise society when almost all women work. And the Nordics are coming up with highly innovative solutions that reject the tired orthodoxies of left and right.

The second reason to pay attention is that the new Nordic model is proving strikingly successful. The Nordics dominate indices of competitiveness as well as of well-being. Their high scores in both types of league table mark a big change since the 1980s when welfare took precedence over competitiveness.

The Nordics do particularly well in two areas where competitiveness and welfare can reinforce each other most powerfully: innovation and social inclusion. BCG, as the Boston Consulting Group calls itself, gives all of them high scores on its e-intensity index, which measures the internet's impact on business and society. Booz & Company, another consultancy, points out that big companies often test-market new products on Nordic consumers because of their willingness to try new things. The Nordic countries led the world in introducing the mobile network in the 1980s and the GSM standard in the 1990s. Today they are ahead in the transition to both e-government and the cashless economy. Locals boast that they pay their taxes by SMS. This correspondent gave up



changing sterling into local currencies because everything from taxi rides to cups of coffee can be paid for by card.

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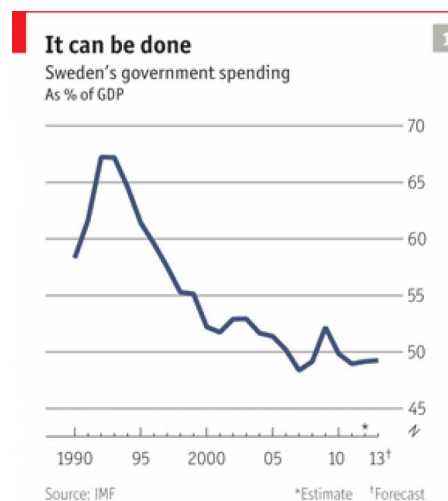
The Nordics also have a strong record of drawing on the talents of their entire populations, with the possible exception of their immigrants. They have the world's highest rates of social mobility: in a comparison of social mobility in eight advanced countries by Jo Blanden, Paul Gregg and Stephen Machin, of the London School of Economics, they occupied the first four places. America and Britain came last. The Nordics also have exceptionally high rates of female labour-force participation: in Denmark not far off as many women go out to work (72%) as men (79%).

Flies in the ointment

This special report will examine the way the Nordic governments are updating their version of capitalism to deal with a more difficult world. It will note that in doing so they have unleashed a huge amount of creativity and become world leaders in reform. Nordic entrepreneurs are feeling their oats in a way not seen since the early 20th century. Nordic writers and artists—and indeed Nordic chefs and game designers—are enjoying a creative renaissance.

The report will also add caveats. The growing diversity of Nordic societies is generating social tensions, most horrifically in Norway, where Anders Breivik killed 77 people in a racially motivated attack in 2011, but also on a more mundane level every day. Sweden is finding it particularly hard to integrate its large population of refugees.

The Nordic model is still a work in progress. The three forces that have obliged the Nordic countries to revamp it—limited resources, rampant globalisation and growing diversity—are gathering momentum. The Nordics will have to continue to upgrade their model, but they will also have to fight to retain what makes it distinctive. Lant Pritchett and Michael Woolcock, of the World Bank, have coined the term “getting to Denmark” to describe successful modernisation. This report will



suggest that the trick is not just to get to Denmark; it is to stay there.

The final caveat is about learning from the Nordic example, which other countries are rightly trying to do. Britain, for example, is introducing Swedish-style “free schools”. But transferring such lessons is fraught with problems. The Nordics’ success depends on their long tradition of good government, which emphasises not only honesty and transparency but also consensus and compromise. Learning from Denmark may be as difficult as staying there.

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