

# CPB Memorandum

CPB Netherlands Bureau for Economic Policy Analysis



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## Nuancing the favourable assessments of the Nordic economies

*This memorandum tries to nuance and qualify recent favourable assessments of the Nordic economies.*

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# 1 Introduction

The Nordic economies have performed well in recent years. Economic growth and labour market participation have been higher than in the euro area; the government budgets have been in surplus; the labour force is highly skilled, the education system leads to good qualifications and to smooth entry to the labour market; the risk of poverty is low. Nordic countries are almost always in the top of country rankings, for instance in the IMD Competitiveness ranking (IMD, 2005). This good performance in recent years has led to favourable assessment of the Nordic economic model (see for instance Aiginger and Guger, 2006; Sapir, 2005; Dutch Ministry of Finance, 2005). This memorandum tries to nuance and qualify some of those favourable assessments of the Nordic economies.

Four Nordic countries are analysed (Denmark, Finland, Norway and Sweden) and compared with the Dutch economy and the euro area. As Norwegian outcomes can be heavily influenced by its oil production<sup>1</sup>, results for the Nordic region are a weighted average of Denmark, Finland and Sweden.

Concerning the Nordics as role model for other economies, one should keep in mind that Nordic economies are very small (Figure 1.1). Their experience and policy may probably not be directly relevant for the euro area as a whole and its bigger member states. Due to greater openness to trade and greater homogeneity of the population, necessary economic reforms may be easier implemented in smaller countries (Elmeskov and Duval, 2005).

**Figure 1.1 The size of the Nordic economies**



Source: OECD, Economic Outlook 78, November 2005.

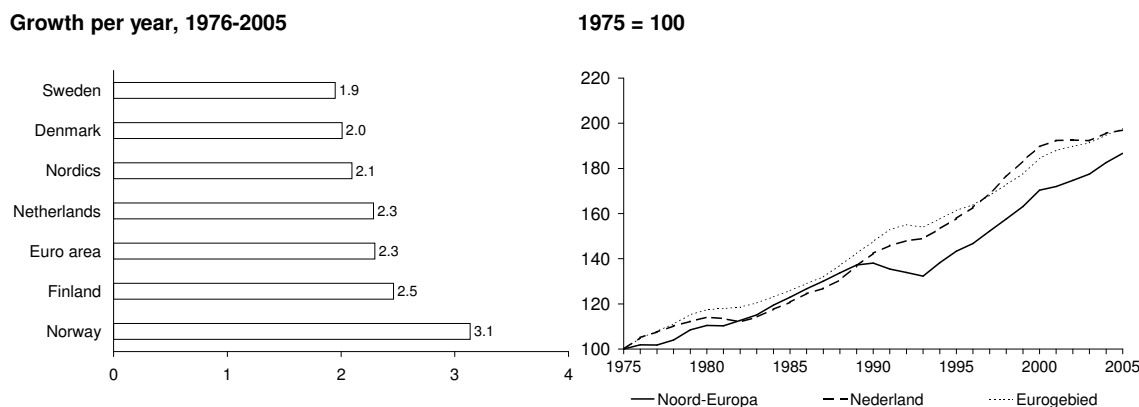
<sup>1</sup> The share of the oil extraction sector in total GDP was 19.7% in Norway in 2004. This compares with a share of 2.6% in the Netherlands.

## 2 Economic growth

In recent years, economic growth of the Nordic economies has exceeded that of the euro area. However, growth differences over a short period can be influenced by temporary or special factors and differences in cyclical phase. Thus, it is preferable to assess economies over a longer period. On average in the past 30 years, economic growth of the Nordic economies has been less than that of the euro area and of the Netherlands (Figure 2.1).

Not only the growth rate itself but also the variation in growth is relevant. All economic agents, including policy makers, prefer a smooth development over a “roller-coaster”. A smooth development is preferable economically as it means less uncertainty and given the asymmetry

**Figure 2.1 Real GDP, 1976-2005**



Source: OECD, Economic Outlook 78, November 2005.

**Figure 2.2 Volatility, 1975-2005**

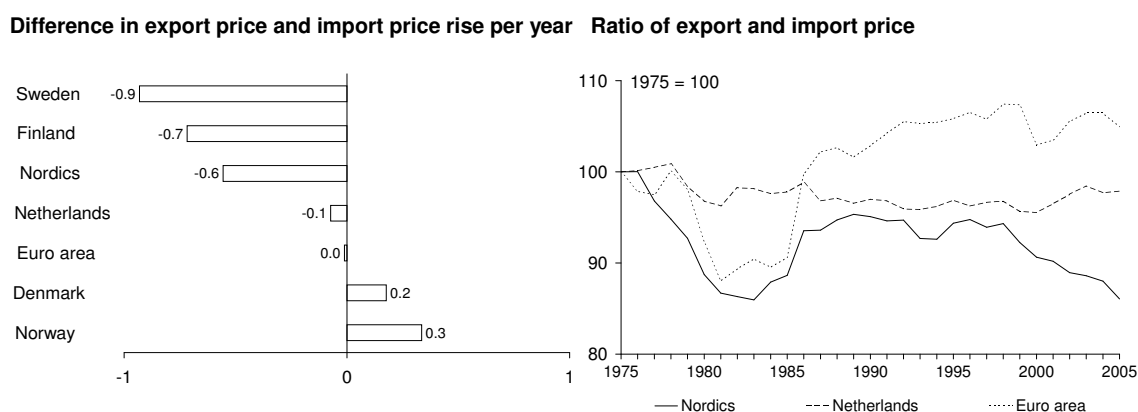


Source: OECD, Economic Outlook 78, November 2005.

in sensitivity for ‘good’ and ‘bad’ times.<sup>2</sup> Also on this point, the Nordic performance is inferior to that of the euro area and the Netherlands. Volatility has been higher in the Nordic economies (Figure 2.2). Both Sweden and Finland experienced a major economic crisis (Figure 2.2). Mistakes in regulatory reform and macro-economic policy played a major role in these crises (Jonung et al. , 2005). In the case of Finland, ‘bad luck’ (the collapse of the USSR) was also relevant.

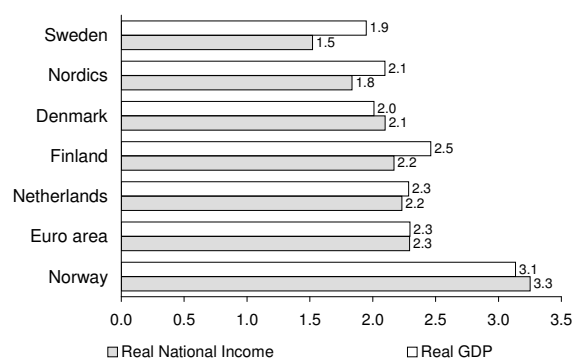
Furthermore, real national income represents a better measure than real GDP growth as it takes into account the terms of trade development. In case of a terms of trade loss, a part of the GDP growth is required for additional exports and cannot be spend on domestic consumption or investment. The Nordic economies have experienced a severe terms of trade loss (Figure 2.3). In recent years, the terms of trade losses of Sweden and Finland are strongly related to their

**Figure 2.3 Terms of trade, goods and services, 1976-2005**



Source: OECD, Economic Outlook 78, November 2005.

**Figure 2.4 Real National Income and real GDP, 1976-2005, percentage change per year**



Source: OECD, Economic Outlook 78, November 2005.

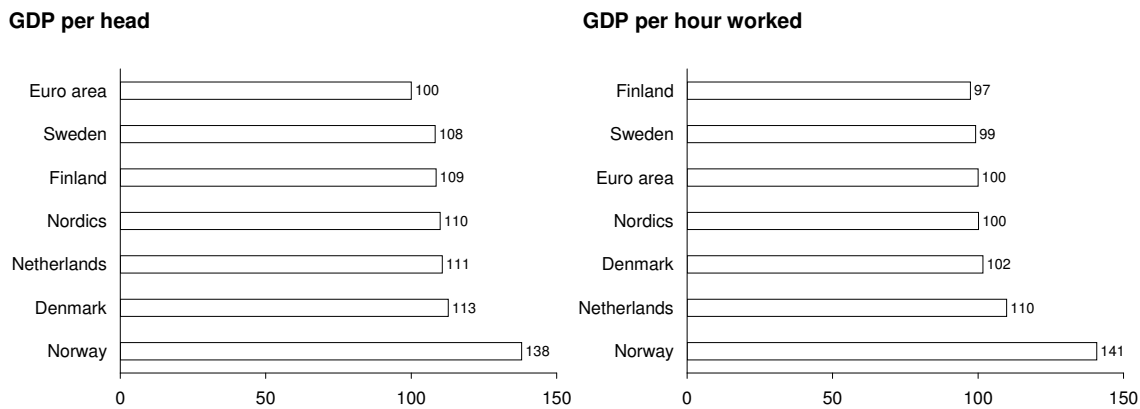
<sup>2</sup> For recent empirical research for consumers see Mastrogiacomo (2006) and Berben et al (2006).

exports of ICT products. Due to the terms of trade loss and weaker GDP growth, the increase of real national income of the Nordic countries lagged substantially (Figure 2.4).

### 3 Income per head and productivity levels

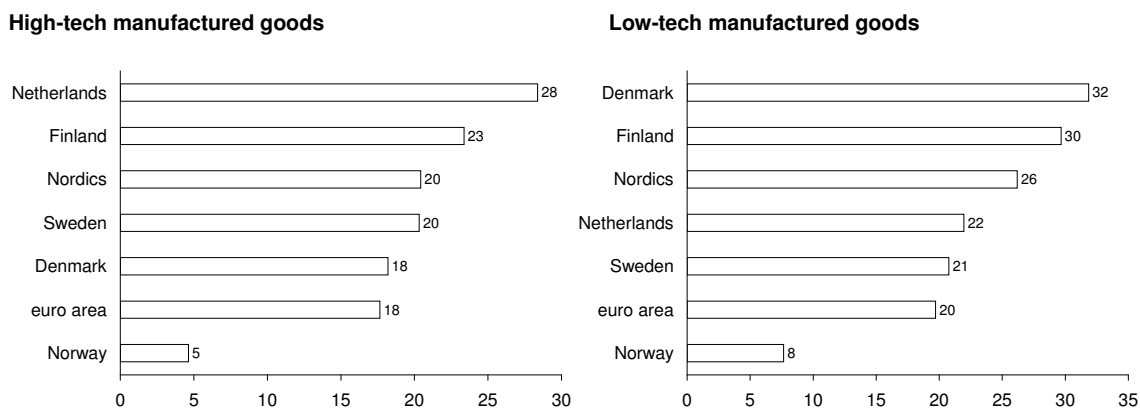
Another important performance indicator is income per head. In the Nordic countries GDP per head is lower than in the Netherlands but higher than in the euro area (Figure 3.1). GDP per head is determined by labour market participation and labour productivity. Perhaps somewhat surprisingly, productivity in the Nordics economies is only on par with that of the euro area despite relatively high outlays for R&D and education. Nordic ICT companies may be eye-catching but their share in the total economy is not substantial enough to cause an outstanding

**Figure 3.1 GDP per head and GDP per hour worked, 2004, Euro area = 100**



Source: OECD, Productivity database, October 2005 version.

**Figure 3.2 Exports of high- and low-tech manufactured goods, 2003, as a percentage of total exports of goods**



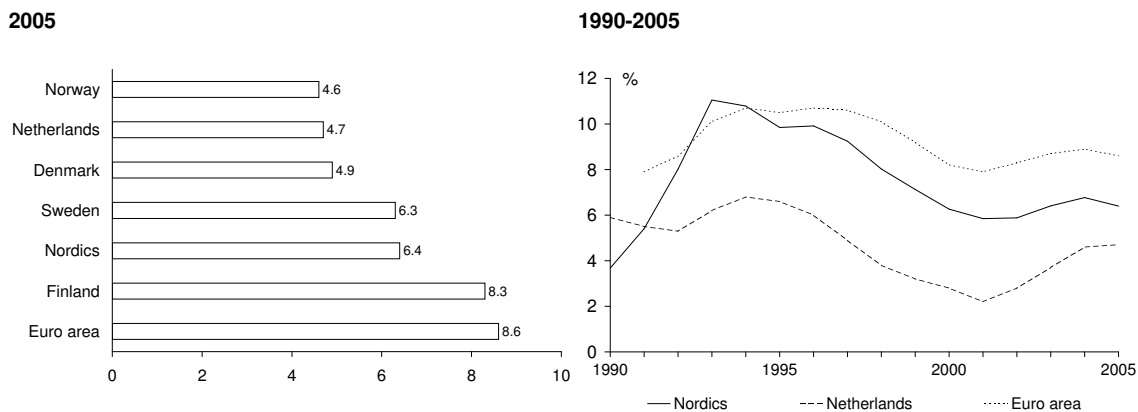
Source: OECD, STAN Bilateral Trade Database (BTD); International Trade by Commodity Statistics (ITCS), 2005.

overall productivity performance. The same holds for the export composition: Nordic exports are biased towards low-tech manufactured goods: the share of high-tech manufactured goods is only somewhat higher than in the euro area while the share of low-tech manufactured goods is clearly higher (Figure 3.2).<sup>3</sup>

## 4 Labour market

Unemployment in the Nordic countries is currently higher than in the Netherlands but lower than in the euro area (Figure 4.1). Sickness absence in the Nordic region is much higher than in the euro area and is clearly a worrying problem (Figure 4.2).<sup>4</sup> Dutch absence was even higher in 1995-2003, but is showing a (partly cyclically-induced) downward trend (Stegeman, 2005). In Sweden, however, the trend is clearly upward, with a doubling of sickness days in five years.<sup>5</sup> Norway has recently experienced a rise as well.<sup>6</sup> Furthermore, just as in the Netherlands, disability is widespread in the Nordics (Figure 4.3). As a consequence of high sickness absence and high disability, the dependency ratios are high in Nordic countries (OECD, 2003c).

**Figure 4.1 Unemployment rate, 1990-2005**



Source: Eurostat, (Sweden, 2005; European Commission, Economic Forecasts, Autumn 2005, October 2005).

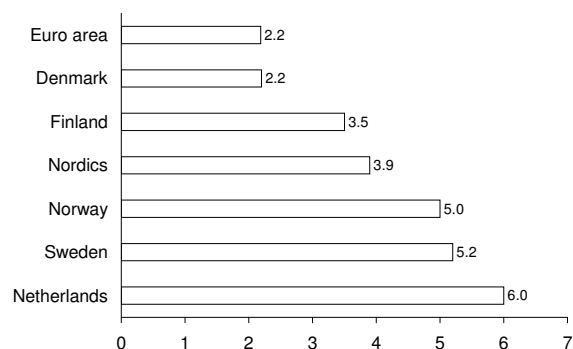
<sup>3</sup> The relatively high Dutch share of high-tech manufactured goods is due to re-exports.

<sup>4</sup> See for instance Rae, 2005.

<sup>5</sup> See [http://www.scb.se/Grupp/statistisk\\_arsbok/\\_Bilder/Sjukskrivn%20diagram\\_eng.swf](http://www.scb.se/Grupp/statistisk_arsbok/_Bilder/Sjukskrivn%20diagram_eng.swf).

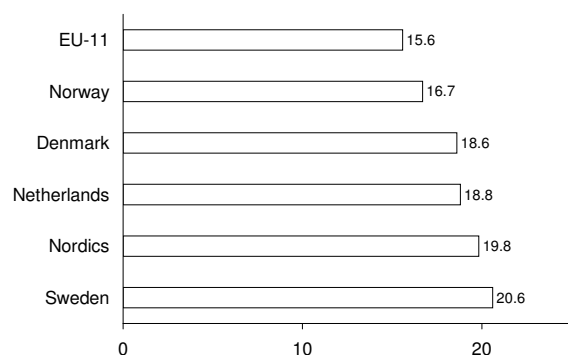
<sup>6</sup> In Norway, sickness absence was up to 6.6% of working days in the third quarter of 2005. See [http://www.ssb.no/english/subjects/06/02/sykefratot\\_en/](http://www.ssb.no/english/subjects/06/02/sykefratot_en/).

**Figure 4.2**      **Sickness absence, 1995-2003, average, as a percentage of total employed**



Source: Bonato, L. and L. Lusinyan, Work Absence in Europe, IMF working paper 04/193, Figure 2 based on Eurostat data.

**Figure 4.3**      **Disability prevalence, as a percentage of 20-64 population, late 1990s**

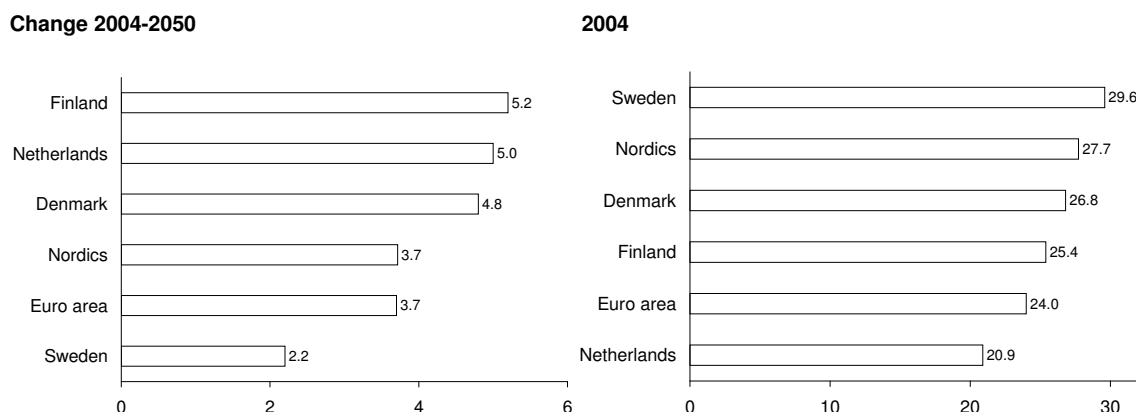


Source: OECD, 2003, Transforming disability into ability: policies to promote work and income security for disabled people.

## 5 Ageing

The ageing issue in the Nordic countries is just as severe as in the euro area. For Denmark and Finland, the ageing challenge is more severe as age-related public spending is projected to increase more (Figure 5.1). Mainly due to its pension reform, this is however not the case for Sweden where currently age-related public spending is the highest in the EU-15.

**Figure 5.1 Age-related public spending, in per cent of GDP**



Source: European Commission, 2006.

## 6 Concluding remarks

The Nordic economies have performed well in recent years. Economic growth and labour market participation have been higher than in the euro area; the government budgets have been in surplus; the labour force is highly skilled, the education system leads to good qualifications and to smooth entry to the labour market; the risk of poverty is low. Nordic countries are almost always in the top of country rankings. But some qualification is required as this Memorandum shows. The policy debate in euro area countries would benefit from more information<sup>7</sup> and more detailed analysis of the Nordic economies, especially as long as the Nordics are “in fashion”. Attention should be paid to the differences between Nordic countries. Attention should also be paid to the critical views expressed in Nordic countries on Nordic economies. In this context, the detailed analysis of the Danish Welfare Committee should be mentioned (Velfærdkommissionens, 2005). It came with 30 proposals to improve the Danish economy.

<sup>7</sup> An example of information not widely known outside the Nordics is the recent abolishment in Sweden of the gift and inheritance tax, while it is a reform widely debated in the United States.



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