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# IN SEARCH OF BEST NORDIC PRACTICE

A CASE STUDY ON  
HOW TO ADJUST TO  
GLOBALISATION



# IN SEARCH OF BEST NORDIC PRACTICE

A case study on how to adjust to globalisation

Confederation of Finnish Industries



**DI**  
DANSK INDUSTRI  
Confederation of Danish Industries



  
SAMTÖK ATVINNULÍFSINS

  
SVENSKT NÄRINGSLIV  
CONFEDERATION OF SWEDISH BUSINESSES

August 2006



**“In many ways the Nordics have entered virtuous circles where various factors reinforce each other to make them among the most competitive economies in the world”.**

Augusto Lopez-Claros, Chief Economist and Director,  
Global Competitiveness Programme, World Economic Forum

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# Preface

Globalisation creates new opportunities. The entrance of a number of new emerging markets on the world stage causes huge increases in the global labour force as well as market potential and competition.

Changes in the competitive environment requires continuous adaptation. Up to now, the Nordic countries have demonstrated the ability to take advantage of the international division of labour and new business opportunities. But many potential gains from globalisation are still to be seized.

This report presents a collection of five cases—casting light on the best Nordic practice within a number of central fields which are all essential for enhanced global competitiveness.

With the report, the Nordic business federations wish to provide a source of inspiration on how to adjust to the new competitive reality. By learning from each other, each country can release huge potential benefits.

August 2006

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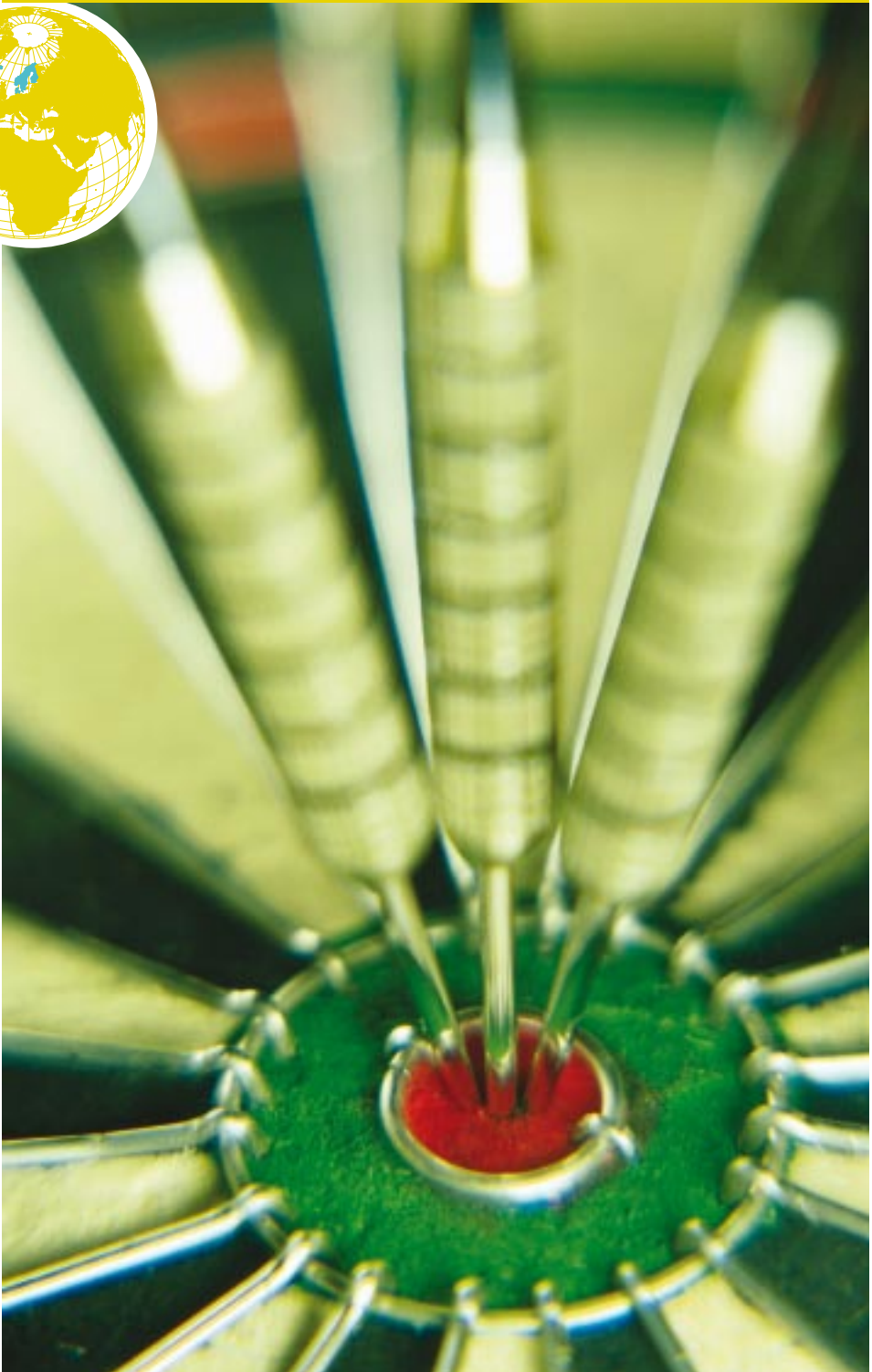
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# Competitiveness in a global world

These years, the Nordic countries distinguish themselves from most of Europe by obtaining high rankings when benchmarking countries' international competitiveness. Hence, they demonstrate ability to gearing up for globalisation.

Nordic countries among the most competitive

IMD WORLD COMPETITIVENESS  
Scoreboard 2006

Country	Ranking
USA	1
Hong Kong	2
Singapore	3
Iceland	4
Denmark	5
Australia	6
Canada	7
Switzerland	8
Luxembourg	9
Finland	10
Ireland	11
Norway	12
Austria	13
Sweden	14
Netherlands	15

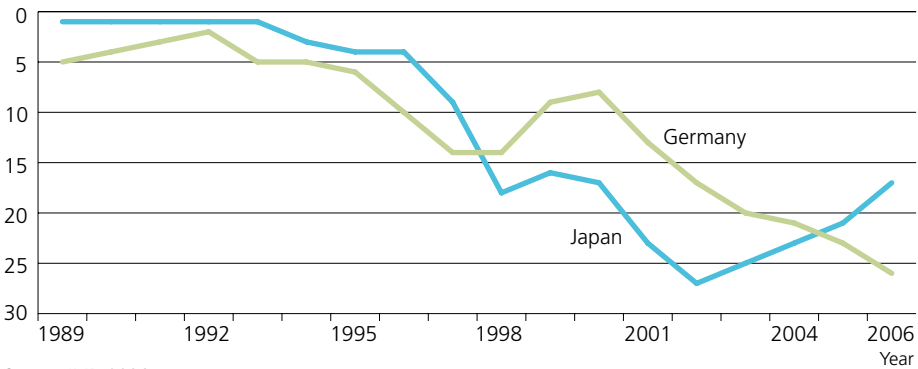
Source: IMD World Competitiveness Yearbook 2006

However, there is no guarantee that the Nordic countries will continue to stay in the lead. History has proven that a good ranking today is not synonymous with a good ranking tomorrow.



## GERMANY AND JAPAN HAVE LOST THEIR INTERNATIONAL LEADING POSITION

Ranking in IMD's international benchmark analysis on competitiveness



For example, during the early 1990s, Germany and Japan were both in the premier league of competitive economies. Today, however, both countries are far from top-rankings.

The keyword is adaptability. Nordic countries have continuously adjusted their systems to globalisation. Those who have not done so have fallen behind.

### Nordic similarities

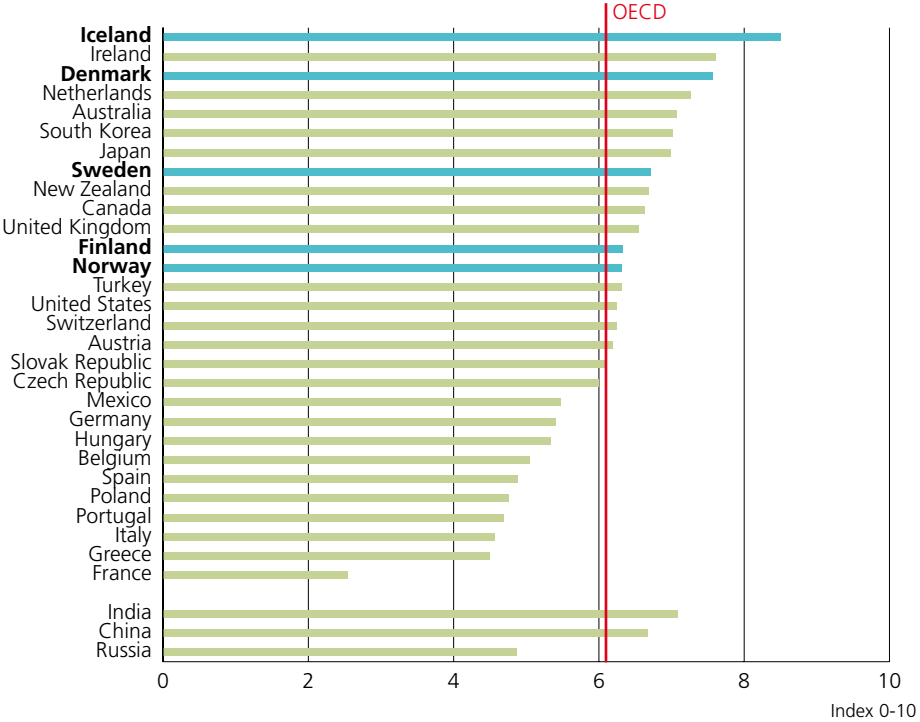
It is not uncommon to hear “the Nordic model” referred to as some unique way of organising the economic and social systems of the Northern hemisphere. And the Nordic countries do have similarities.

First of all, they are all small and open countries. Therefore, globalisation plays an increasing role to the Nordic economies. The whole world has become the market for the Nordic countries—not just for exports and imports but also for investment, outsourcing, and exchange of labour and knowledge.

#### Equal mindset

The most obvious common denominator is to be found in the Nordic mindset. Nordic populations see themselves as being somewhat related—and this breeds a common understanding of how to approach globalisation. This is for instance expressed in the fact that the Nordic populations are among those with the most positive attitude towards globalisation.

ATTITUDE TOWARDS GLOBALISATION, 2006



Source: IMD survey 2006

Additionally, the Nordic countries profile themselves by aiming at high levels of knowledge and competence. For example, all Nordic countries are ranked high in the OECD when it comes to total investments in research and development as a percentage of GDP, public spending on education, and the use of the internet.

High level of knowledge and competence

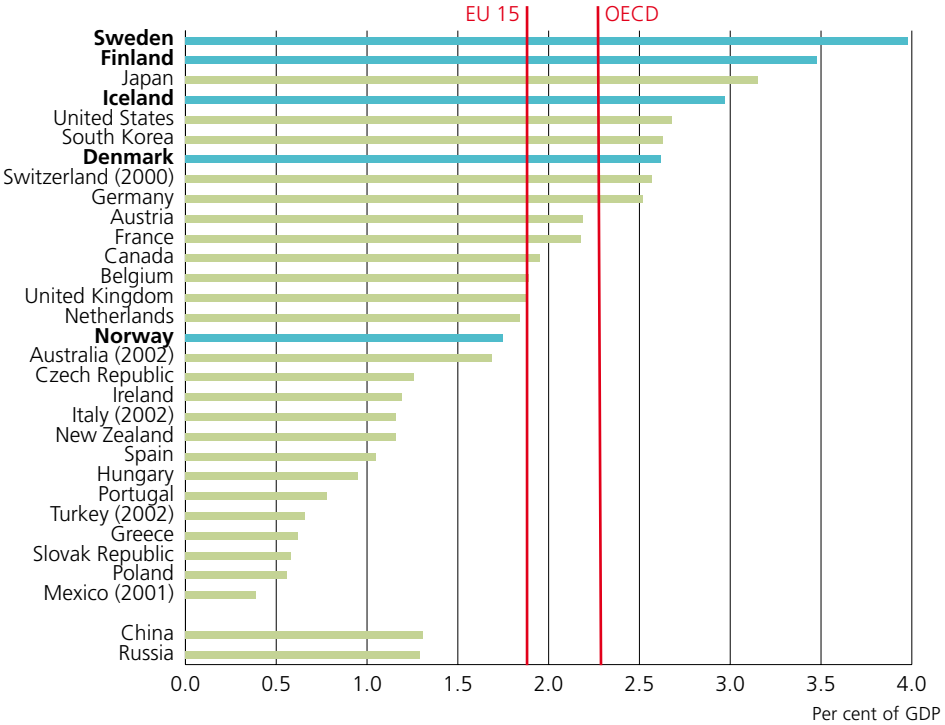
Thirdly, the Nordic countries to a certain extent build on the same kind of social structure as they all have large public sectors. Consequently, large parts of the Nordic workforce are employed in the public sector.

Large public sectors

With the large public sectors follow high tax levels. Nordic countries all receive bottom-10 rankings in the OECD when it comes to tax burdens.

High tax levels

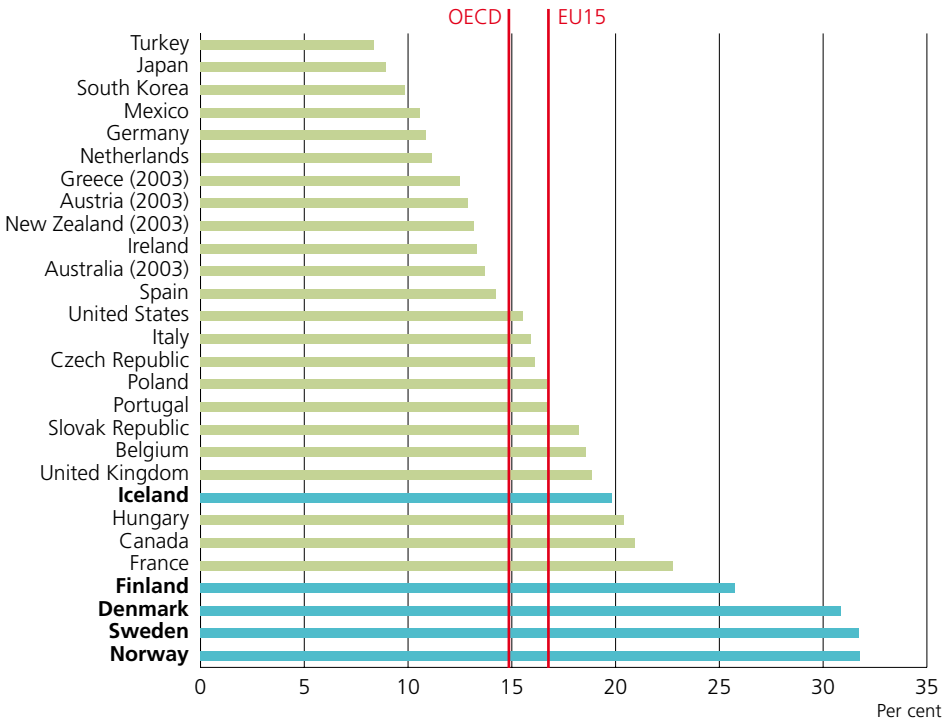
RESEARCH AND DEVELOPMENT EXPENDITURES AS A PERCENTAGE OF GDP, 2003



Similar managerial tradition

Finally, the Nordic countries are widely characterised by having similar managerial traditions. This means short distances between leaders and employees. The non-hierarchical structures in Nordic businesses is sometimes highlighted as an ingredient for creating engaged, independent and innovative employees.<sup>1</sup>

PUBLIC SECTOR EMPLOYMENT AS A PERCENTAGE OF TOTAL EMPLOYMENT, 2004



Source: OECD

# In search of Best Nordic Practice

No single Nordic model

While having much in common the Nordic countries all have unique identities and ways of organising their systems. In other words: There is no single Nordic model.

Due to the different strongholds and shortfalls, the countries face a number of different challenges. Consequently, it is obvious to look into those fields where the individual Nordic countries are role models. This way, each country can seek inspiration on how to strengthen their international competitiveness.

Taking into account the similarities, four relevant areas are revealed:



Danish flexicurity

The Danish labour market is known for its flexibility. International surveys by the IMD, the World Bank and the OECD have for years ranked the Danish labour market as one of the most flexible in the world. Today, Denmark faces some of the world's lowest unemployment rates.

Finnish innovation

Innovation is an essential part of a global winner strategy for all countries. Finland is an international forerunner in the development of a national innovation system. The system is characterized by three ingredients; competition, co-operation and networking.

Icelandic tax policy

Tax conditions are crucial for the competitiveness of businesses. Successive tax reforms have helped transform the business climate in Iceland in the past 15 years, creating a healthy entrepreneurial environment that, in turn, has led to high rates of economic growth and increased living standards.

In a globalised world it is increasingly important to get the most and best out of the labour force available. National co-operation between employees' and employers' organisations and the authorities, with a common focus on a better work-life, has resulted in a relatively large reduction of sickness absence in Norway in a short period of time.

Norwegian  
work life

Competition and liberalisation of tasks which have traditionally been solved by public suppliers can add efficiency to product and service markets and lead to lower prices. The Swedish liberalisation process has been a vital injection for the Swedish economy, resulting in more efficient product and service markets and thus higher productivity.

Swedish  
deregulation



# Flexibility adds value

**Flexibility and adaptability are some of the key prerequisites for success in a global economy. Flexible employment and redundancy regulations give businesses a clear advantage in making it relatively easy to switch production and staff in response to changing conditions.**

**The Danish example shows that labour market flexibility and job security are not contradicting terms but go hand in hand.**

## Survival of the fittest

Companies face a Darwinian struggle in a globalised economy. Only companies who are able to adapt rapidly to the constant changes in market demands will survive. The ability to adapt requires flexible labour markets.

The Danish labour market is known for its flexibility. International surveys by the IMD, the World Bank and the OECD have for years ranked the Danish labour market as one of the most flexible in the world.

250,000 Danish jobs are closed down each year, but at least as many are created. The turnover rate is consequently high. 800,000 Danes change to another job each year.

Today, the rate of unemployment is historically low and the level of employment is high.

At the same time, the level of security for the employee on the Danish labour market is high. In addition to the system that enters into force when people are hit by unemployment, the security aspect is highly linked to the ability of getting a new job if you lose or quit your old one.

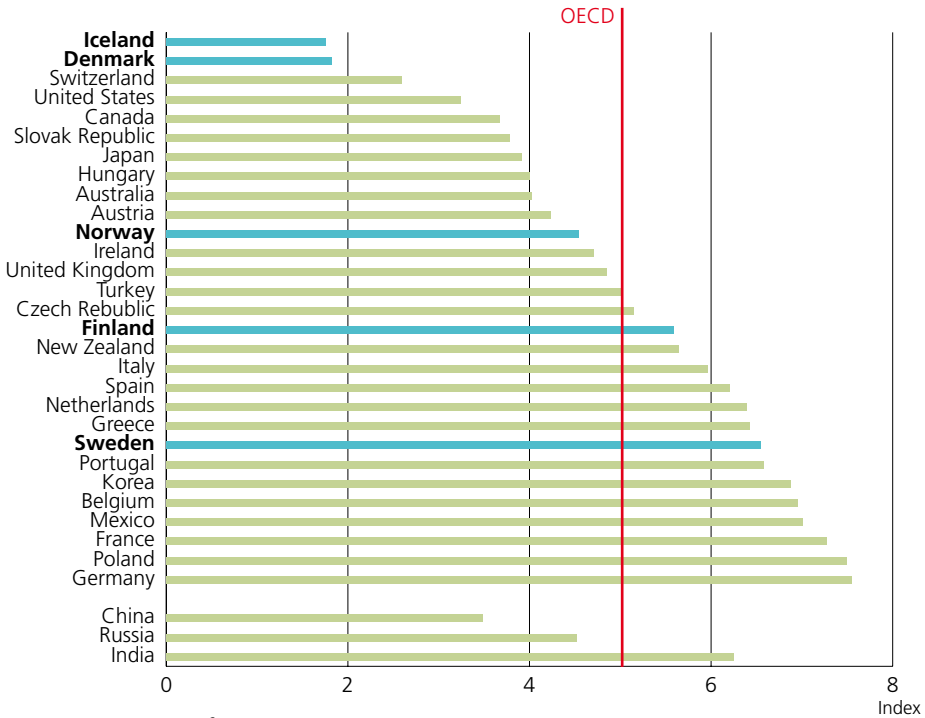
Danish labour market is flexible

Historically low unemployment

High level of security



LABOUR REGULATIONS, 2006



Source: IMD survey 2006 <sup>2</sup>

According to a recent survey by Roy Morgan International and Gallup International on unemployment expectations among people who work full-time or part-time in 67 countries, workers in Denmark (72 per cent) are most likely to believe they could quickly find a new job in case of unemployment, followed by workers in New Zealand (71 per cent) and Canada (65 per cent).<sup>3</sup>

The flexicurity model

The simultaneous presence of both flexibility and security on the labour market has developed a labour market model that seems to meet the challenges of globalisation.

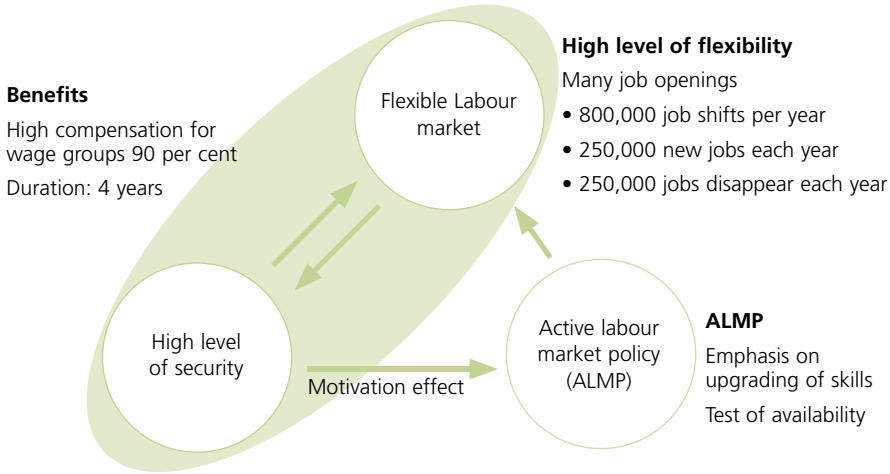
Companies can adapt to changes while employees retain a feeling of security.

Basically, the flexicurity model consists of three pillars:

Three pillars

1. the flexible labour market
2. the high level of security
3. the active labour market policies

THE DANISH FLEXICURITY MODEL



Source: Confederation of Danish Industries, 2006

Flexible labour market

In Denmark, it is relatively easy to hire and fire employees. Unlike Sweden, Norway, and Finland, Denmark has no general labour code that regulates notices of dismissals or defines on which ground an employee can be dismissed.

Despite an increasing number of EU directives, most labour market regulation in Denmark is applied by collective agreements, not by law.

Collective agreements —not laws

The collective agreements are concluded between social partners who have engaged in a constructive relationship for more than a century. Today, trade unions and employers organisations agree on the advantages of flexibility combined with security. There is a shared understanding that employment security is more important than job security, i.e. instead of making it difficult for employers to change their workforce, focus should be directed at making it attractive to create as many new jobs as possible. In other words the common philosophy is to protect people, not jobs.

Protecting people, not jobs

High protection  
may cause lost jobs

If employees are protected against dismissals in their current jobs—either by formal procedures or long notices of dismissals—companies will not be able to adapt and will thus lose their competitiveness. In the long run, companies may have to go out of business and jobs are lost. Even in times of prosperity, companies will hesitate to hire new employees, fearing to get stuck with them in times of adversity.

Optional extension  
of weekly work

The flexibility concept has left great scope at local level for company-tailored solutions. Since 2004, management and employee representatives at company level in industry have been able to make agreements on working time, over time pay, and cooperation forms that differ entirely from the stipulations in the collective agreements. In times of demand, for example, the local parties can agree on extending the 37 hours of weekly work to 42 hours.

High  
unemployment  
benefits

#### High level of security

Danish employees do not consider globalisation as a threat to their future employment. On the contrary, they are the most optimistic employees in the North. Besides, Danes are more satisfied with their jobs and more motivated than the other Nordic employees.<sup>4</sup>



The security dimension in the Danish labour market and Danish employees' optimistic look at the future are to a large extent linked to the high possibility of finding a new job in case of unemployment. This is mainly a result of flexible employment and redundancy regulations which make it easy for companies to adjust to changing conditions and thus less risky to hire new staff.

Another security dimension is of course unemployment benefits which are generally high in Denmark. People who are insured in the event of unemployment are entitled to benefits covering up till 90 per cent of their previous wage—with a monthly ceiling of approximately 1,800 euro. For an average skilled employee working full time, the compensation rate is around 75 per cent.

The generous security provisions provided by law and by the collective agreements are—in addition to the very high Danish wage levels—costly for the employers both directly and indirectly through high tax levels—and are hampering companies' international competitiveness. Additionally, with a demographic development leading to huge reductions in the active labour force, the system should be adjusted to make sure that no one is kept outside the labour market on passive benefits longer than necessary. Therefore, the security provisions should always be balanced as to ensure incentives to educate and work. Consequently, provision payments should not grow too high.

Costly for employers

### Active labour market policies

The third pillar of the Danish flexicurity is the active labour market policies. When an employee becomes unemployed, he or she is entitled to four years of unemployment benefits. However, certain obligations follow.

Obligations for the unemployed

Basically, the employment services make use of two methods for bringing the person back into employment. First, the motivation effect is intended to give the unemployed greater incentives to find work. This is done by way of various activation schemes and by systematically matching skills and experiences to new job openings.

Activation schemes

The qualification effect is directed at upgrading the specific skills the unemployed person has to match more job openings, i.e. to increase work adaptability.

Upgrading

While the collective agreements leave great scope for flexible solutions at company level, and thus create as many new jobs as possible, the active labour market policies are intended to ensure that the unemployed constantly have the skills needed and are ready to re-enter the labour market.

## Conclusion

Negotiation  
between the parties

The Danish labour market model is built on common understanding between the labour market parties. Obviously, the model causes discussions and negotiations during the collective bargaining process. However, both parties take a large responsibility by being modest as regards wage development—not least to limit inflation rates.

Access to the  
necessary  
labour is crucial

It is crucial for companies to have access to the necessary labour force. The demographic development over the coming years will create enhanced pressure on welfare systems and will challenge companies' access to skilled labour supply.

In this regard, it could be argued that the Danish flexicurity model acts as a Nordic role model. However, it is crucial that Denmark uses good times to create space for those who have the weakest attachment to the labour market—e.g. certain groups of immigrants, elderly employees, and handicapped people.

Approximately 20 per cent of Denmark's working-age population are not active in the labour market. This indicates remarkable room for improvement in the Danish labour market model. One solution would be to lower income taxes. This would increase the incentives to education and work, not least for foreign workers.

20 per cent outside  
the labour market

Within few years, one of the limiting factors for growth and innovation will be the access to skilled labour.

#### POLICY RECOMMENDATIONS

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Lessons learned from the success of the Danish flexicurity model make the Nordic business federations recommend:

- Nordic countries must keep or establish flexible labour markets in which everybody is encouraged to take active part.
  - The security dimension in the Danish labour market model brings many advantages. However, high social payments reduce incentives to work and becomes increasingly problematic in a time where it gets still more important to integrate as large a proportion as possible of the people of working age in the labour market. Therefore, social payments must be kept at a level that ensures economic incentives to work. Flexicurity requires constant balancing of the level of per diem allowance, assistance in job seeking, and retraining.
-



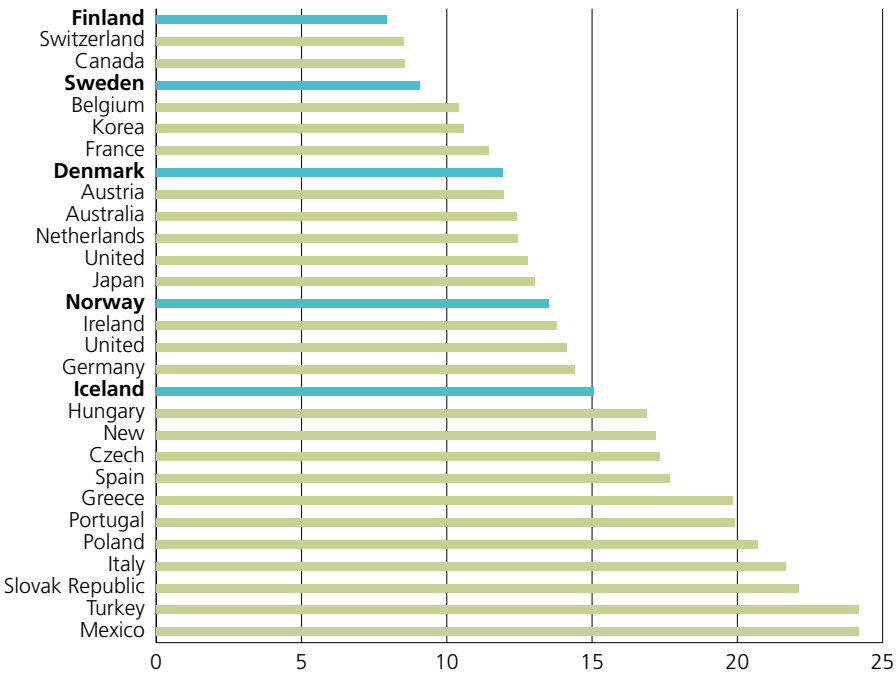
## FINLAND IN THE WORLD

# Paving the way to global success through Innovation

**Knowledge is an increasingly important factor in today's global economy. Harsh international competition and the rapid development of technology bring along a growing need for knowledge and competences. One of the cornerstones for a successful globalisation strategy is investments in the innovation system.**

### KNOWLEDGE AND COMPETENCE

Average ranking of countries



Source: DI's Global Benchmark Report 2006<sup>5</sup>



International reviews have found Finnish science and technology policy to be both systematic and profitable. Finnish business has successfully been able to affect the national innovation system during the last decades.

Finland has been an international forerunner in the development of the national innovation system. The science and technology policy in Finland has gradually moved on from separate examinations of different components to a more comprehensive approach. The national innovation system is composed of the producers of new knowledge and know-how, their users, and the various ways in which they interact.

### Shared responsibility

Central elements in the Finnish innovation system are education and training, research and development, knowledge-



intensive businesses, and financing, including venture and equity financing. Versatile international co-operation permeates through the whole system. Characteristic to the Finnish innovation system is competition, co-operation and networking.

Knowledge is produced by for instance universities and polytechnics, research institutes and businesses. It is chiefly used by businesses, private individuals, and the decisionmakers and administrations responsible for the development of society.

The national science, technology, and innovation policy is formulated by the Science and Technology Policy Council, which is chaired by the Prime Minister. The organisations primarily responsible for the science, technology and innovation policy are the Ministry of Education and the Ministry of Trade and Industry.

The Ministry of Education is in charge of matters relating to education and training, science policy, institutions of higher education, and the Academy of Finland. The Ministry of Trade and Industry deals with matters relating to industrial and technology policies, the National Technology Agency (Tekes), and the Technical Research Centre of Finland VTT. Nearly 80 per cent of government research and technology funding is channelled through these two ministries.

The basics of today's innovation system were laid in the beginning of the 1980s. Tekes was established and large technology programmes were taken into use. The technology programmes consist of research projects by companies, universities, and research institutes, plus services that support companies' business operations, such as shared visions, seminars, training programmes and international visits. National objectives for research and technology inputs were set. Both companies and the government have increased their research and technology investments quite steadily during the past two decades.

The technology programmes provide opportunities for companies to network and develop business expertise and skills in international operations. There are some 1,800 instances of corporate participation in the technology programmes every year and about 500 instances of participation by research units. A total of 25 extensive national technology programmes were started in the autumn of 2005.

National objectives

International networks

Know-how important for small economies

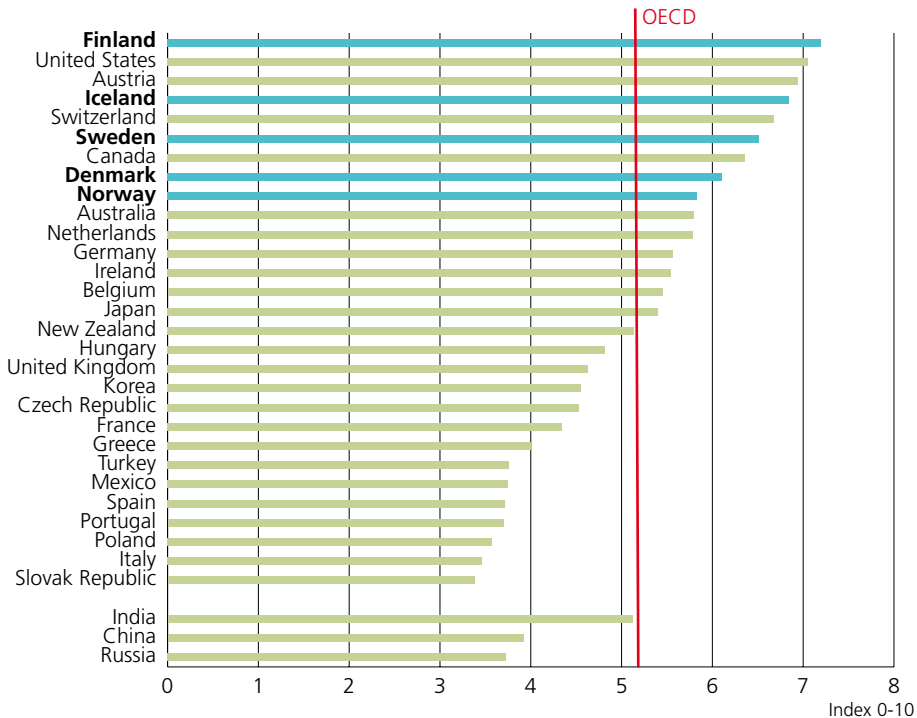
Behind the reforms of the early 1980s was the idea of knowledge and know-how being important for a small country's economy and welfare. The competitiveness of Finnish export products was insufficient and this led to the development of the Finnish innovation system through the joint understanding of industry and public authorities.

Early liberalisation process

Another important decision that took place in the same time was the dismantling of monopolies and the deregulation of the telecommunications sector. Competition forced the players to develop their own products, new technology, and efficient systems. When the markets opened up elsewhere, Finnish companies, now tempered by competition and technology, were ready for it.

Competition as a driver for innovation

#### KNOWLEDGE TRANSFER BETWEEN UNIVERSITIES AND COMPANIES



The innovation system approach has also been gaining importance within regional development. The Finnish network of higher education institutions, technology centres, centres of expertise, and other similar operational players have promoted innovation in the regions to the extent that Finland now speaks of regional innovation systems and their development.

Regional innovation

## Conclusion

The Finnish innovation system has functioned well. Finland has performed well in terms of e.g. technology, information society, and environmental competitiveness. Due to global economic and technological competition there is, however, a need for further development. The Finnish Government has indicated its commitment to increase public innovation financing in purpose to reach four per cent R&D financing level of the GDP by 2010. Currently the share is 3.5 per cent of GDP. With this figure Finland ranks two among the OECD countries, Sweden being first.

Well-functioning system ...

... but room for improvement

At present the private sector accounts for more than 70 per cent of the total expenditure, while the public sector's share has decreased to below 30 per cent. Government funding of business R&D is one of the world's lowest.

From a business point of view, additional public investment is particularly needed in order to restore technological competitiveness and strengthen the conditions of first class research activity in sectors that are vital to the competitiveness of enterprises as well as to the economic growth and the development of productivity.

More public investments needed

Service business and service innovations together with innovation processes are important areas which need more resources. In terms of the development of business competences and skills it is important that the technological development, business economics, and business management education based on business needs are also forcefully developed. The ground of the innovation system—the university and research institution network—needs reforms to respond to the global challenges.

Besides increasing the financing, it is important that the whole innovation system is developed in a more business and market oriented manner, because innovations emerge best in competitive and well-functioning markets. This encourages

More business and market orientation needed

Including SMEs

companies to innovate, and entrepreneurs and owners to take risks. The incentives for growth and entrepreneurship must be improved. Promoting entrepreneurship and internationalisation of SMEs as well as liberalisation of especially services markets are among the current developing areas. The prerequisites for venture capital and equity markets must simultaneously be developed in order to safeguard the financing of many of the SMEs and start up companies.

Four challenges

The challenges of the innovation policy cover four main themes: the creation of an innovation friendly market, the augmentation of R&D resources, new dynamic structures, and the creation of an appreciative culture for innovations and entrepreneurship.

## POLICY RECOMMENDATIONS

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Lessons learned from the success of the Finnish knowledge-based strategy make the Nordic business federations recommend to ensure:

- Capability for constantly generating new high-standard and relevant knowledge
  - Efficient and unimpeded diffusion of knowledge and know-how between knowledge institutions and businesses
  - Advanced capability for exploiting knowledge produced abroad
  - Effective horizontal partnerships in the domain of knowledge which permeates through society, as a result of which network-building across sectoral boundaries comes naturally
  - Deregulation and dismantling of monopolies
-





## ICELAND IN THE WORLD

# Tax reforms as building blocks for economic success

**Success in the global economy requires a competitive relationship between costs, quality, and productivity. Due to expensive welfare systems in all the Nordic countries their competitive position is constantly threatened by high tax burdens that hamper initiative and growth.**

**Iceland's recent experience with tax reforms demonstrates the positive impact of more moderate taxes and the dynamic effects on public tax revenue.**

Economic development in Iceland has been particularly favourable during the past decade. Average annual growth rates above four per cent and significantly improved living standards have made Iceland attract international attention. In 2004, Iceland was number seven among the OECD-countries in terms of GDP per head (adjusted for price differences).

Comprehensive structural reforms of the economy are the main reason for this success. The broad thrust of the reforms has been to open up the economy to international competition and promote private enterprise with comprehensive deregulation and privatisation. At the same time, the upswing has been reinforced by successive tax reforms which have helped restructure the entrepreneurial sector and enabled Icelandic firms to gain ground abroad and made foreign investments more attractive.

Comprehensive structural reforms

Successive tax reforms

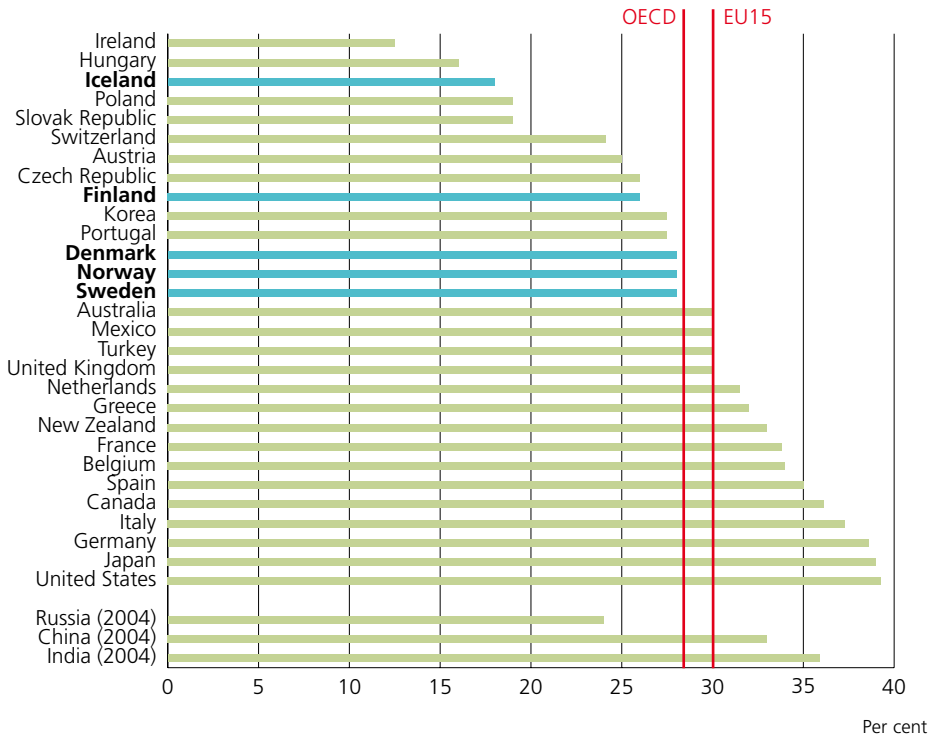
Reforms motivated by a stagnant economy

In the early 1990s, the economic situation in Iceland was difficult. Growth was close to a standstill, unemployment on the rise, company profits low and prices still partly regulated. The legacy of doubledigit inflation from the 1970s and 1980s was still looming. At the same time, Iceland was actively participating in negotiations on the EEA Agreement and the WTO Agreement, both of which were bound to transform foreign trade and further expose domestic companies to global

Difficulties in the 1990s



## CORPORATION TAX RATE, 2005



competition. This situation prompted a new economic policy approach designed to improve the competitive position of Icelandic businesses.

Corporate tax reform in 1992

At the end of the 1980s, corporate income tax in Iceland stood at 50 per cent. A corporate net wealth tax was also applied, raising the effective tax rate and placing Iceland close to the top of OECD countries. On the initiative of the incoming government in 1991, preparations were made to improve the business climate. Tax measures approved in the autumn of 1992 included cutting corporate income tax from 45 to 33 per cent, which at the time was among the lowest in Europe. Business taxation was further improved by abolishing the municipalities' turnover tax.

The central government's tax cuts were financed by a 1.5 per cent increase in the personal income tax rate and the introduction of a five per cent temporary surtax on personal income above a certain level.

### Capital income tax harmonised in 1997

In 1997, a major tax reform was implemented when a uniform 10 per cent capital income tax was introduced. This change represented a complete overhaul of the former system. Before, there were large discrepancies between taxation of different forms of saving with distorting effects on the saver's or investor's choice. Interest income was tax-exempt while other capital income was subject to a full personal income tax. The 10 per cent capital income tax covers interest earnings, capital gains, rents, and dividends. Capital income incurred by companies would now be taxed as ordinary corporate profits with the withholding capital income tax being offset against the final income tax assessment.

10 per cent capital income tax

The new approach to taxing capital income did not result in any adverse effects on the Treasury's revenue. On the contrary, tax revenue has by far exceeded the first estimates. In 2005 revenue from the tax was in real terms more than four times the amount collected in 1998. The main reason for the strong growth is that lower tax on capital gains, rents, and dividends, together with the simple formulation of the tax system, revitalised a previously dormant market. Investors

Modest tax level leads to growth in revenue.



were encouraged to buy shares rather than put their money into interestbearing assets which in turn helped promote a viable stock market. At the same time, companies were more willing to pay dividends, since they would only be taxed 10 per cent at the shareholder level.

### Corporate tax reform in 2001

Corporate tax 30 per cent in 1997

Following the reduction of the corporate tax rate in 1992 to 33 per cent and the further reduction to 30 per cent in 1997, the tax regime was for a while fairly competitive. However, the tax base had been broadened at the same time by eliminating various exemptions and reductions. Consequently, the effective tax rate did not improve correspondingly.

Intensified global competition ...

In the course of the 1990s, global competition intensified. This induced many governments to seek ways to enhance the competitive position of domestic companies, not least by lowering taxation. The competitive edge established by the earlier tax reforms had therefore largely been eroded at the end of the 1990s. This was the main reason for the corporate tax reform decided upon in the autumn of 2001.

... eroded competitive edge

Tax revenue up by 160 per cent

The reform included a reduction of corporate income tax from 30 to 18 per cent. At the same time, corporate net wealth tax was reduced from 1.2 to 0.6 per cent as from the end of 2002 and corporate net wealth surtax (0.25 per cent) was abolished. In order to partly compensate for the revenue loss social security tax on employers was raised from 5.23 to 5.73 per cent, to take effect as from 2003.

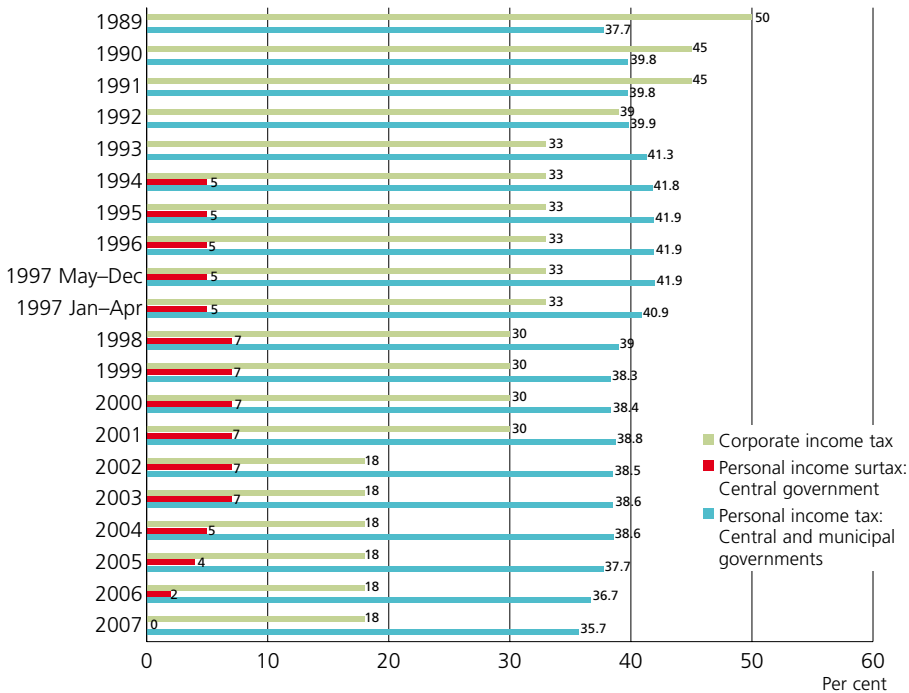
These tax reforms rank among the most comprehensive in decades, with the gross revenue loss of the Treasury amounting to about 1 per cent of GDP. The authorities tried to take account of the dynamic effects of the tax cuts, concluding that the net loss of tax revenue was only 0.5 per cent of GDP. In reality the dynamic effect turned out to be even stronger. The impact of the tax cuts on public revenue can be summarised by stating that while the corporate tax rate was lowered from 50 per cent in 1989 to 18 per cent in 2002, revenue from the tax has grown by 160 per cent in real terms.

### Tax cuts decided in 2004

Reducing personal income tax

At the end of 2004, substantial tax cuts were approved by the parliament. They focus on reducing the personal income

## PERSONAL INCOME AND CORPORATE TAX RATES IN ICELAND



Source: Ministry of Finance, Iceland

tax-rate by four per cent.<sup>6</sup> The measures are implemented stepwise, by a one per cent cut in 2005, one per cent in 2006, and two per cent in 2007. However, in connection with preventing cancellation of ongoing collective wage agreements, the government decided in June 2006 to raise the personal tax credit by 10.8 per cent as from January 2007, while the reduction of the tax rate will be one percentage point in stead of two. The measures also involve abolition of net wealth tax on persons and corporations as from 2006 as well as a review of value added tax in 2007. The parliament had earlier decided to phase out the surtax on personal income, with a stepwise reduction of the tax rate from seven per cent in 2003 to a full abolition in 2007. The implication is a significant reduction in marginal tax rates particularly for medium and higher paid wage-earners.

Large fall in marginal tax rates

### Conclusion

Successive tax reforms have helped transform the business climate in Iceland in the past 15 years, creating a healthy en-

trepreneurial environment that, in turn, has led to high rates of economic growth and increased welfare. This has been possible without endangering public revenue.

Further adjustments  
required

However, in order for the Icelandic tax system to provide a globally competitive climate for business and investments in the near future, further adjustments are required. For instance, Icelandic tax law lacks neutral and modern provisions on taxation of dividends and capital gains from holdings of companies domiciled abroad. Iceland also needs to step up efforts to conclude double taxation conventions.

Demography  
increases pressure  
on tax system

Looking at the Nordic countries in general, the share of old people in the populations will rise substantially in the near future. This will gradually increase the pressure on the tax systems. The need for adjusting the tax systems to stimulate work performance and growth is therefore evident.

High tax hampers  
initiative

High tax burdens are a clear handicap for the Nordic countries to compete in the global economy. High income taxes reduce the incentive to work, frighten off talent and hamper business investments.

## POLICY RECOMMENDATIONS

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Lessons learned from the success of the Icelandic tax reforms lead to the following recommendations of the Nordic business federations:

- Reforming tax systems is an indispensable element of a winning strategy. If the strategy of commitment to highly productive jobs is to succeed, it is crucial to alter the Nordic tax systems to make it more attractive to work and do business in the Nordics
  - Lower marginal taxes should not be financed by increasing other rates and dues but through larger restraints on public spending on services, first of all on the transfer payments
  - Nordic business taxation must be brought down to a level where it does not distort international investment decisions—neither the volume and type of investments undertaken nor where they are located.
  - The Nordic business organisations would welcome further efforts by governments in this respect, where Iceland can to some extent serve as a role model
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## NORWAY IN THE WORLD

# Preparing for globalisation through better work-life

**In a globalised world it gets increasingly important to get the most and best out of the available labour force. This applies when it comes to obtaining high participation rates as well as when it comes to creating conditions to get the most out of each active employee.**

**In this regard Norway has within few years obtained tremendous results.**

Only few years ago, Norway struggled with a high level of sickness absence. National co-operation between employees' and employers' organisations and the authorities, with a common focus on a better work-life, has resulted in a large reduction of sickness absence in a short period of time.

National  
co-operation

An evaluation from 2005 showed a reduction of 10 per cent from 2001 on a national level in the absence due to sickness. The majority of the private sector had achieved the objective of a 20 per cent reduction in sickness absence. An estimate from the national budget of 2005 indicates that the reduction represents about 25,000 man-years of work in 1–2 years.

Large reduction in  
sickness absence

Reduction  
represents 25,000  
man-years of work

The proposal for public expenditure due to sickness is between 450 and 500 million euro lower for 2006 than it was in 2003, the year before the reduction in sickness started. The positive effect is of course that more resources are available for public welfare and tax reductions.

### Agreement on a more Inclusive Worklife (IW)

In recent years, the trend in Norway has been for more and more employees to leave their workplace for long-term benefits arrangements, with a consequent impact on the individual, the enterprise, and society. To reverse this trend and strengthen worklife, the Agreement on a More Inclusive Worklife was concluded in 2001.



Three objectives

The agreement was signed by four employers' organisations, four employee unions, and the authorities in October 2001 and ran until the end of 2005. The agreement's general objectives were aimed at contributing to a more inclusive workforce for the benefit of the individual, the workplace and society. The agreement has three operative objectives: To reduce sickness absence by 20 per cent during the term of the agreement; to employ more individuals with impaired functional capacity; and to raise the effective retirement age.

Organisation of work

Securing quick handling

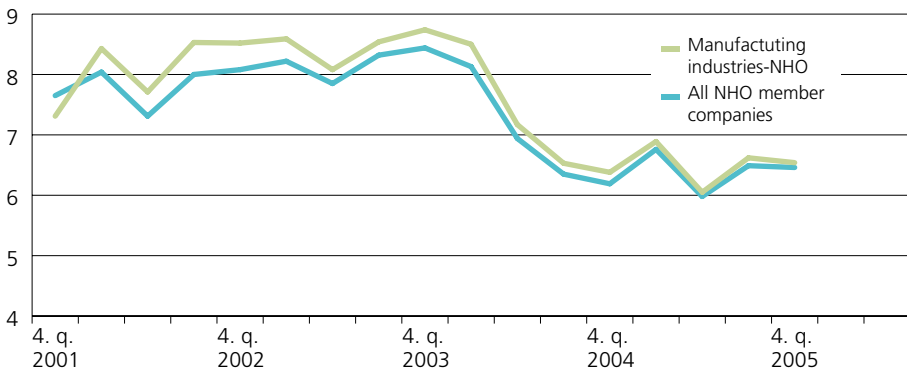
To meet these objectives, every workplace has to focus its attention on this task. The authorities set up the National Insurance Service Workplace Centre, which appointed a contact person to each enterprise signing the IW. Setting up this centre means that enterprises no longer have to deal with several different offices, which ensures that cases of sickness absence are handled quickly. The contact person also assists the enterprise in its IW work. The social partners recruited enterprises and prepared material for the practical work.

50 per cent of employees included

Enterprises undertake to organise work in line with the IW agreement and sign a co-operation agreement with the Workplace Centre. Enterprises have to widen opportunities for employees to sign themselves off sick, while the National Insurance Service makes a number of measures exclusively

THE REDUCTION OF PEOPLE ON SICK LEAVE FROM 2001-2005

Absence in per cent of agreed day's work for all workers



Source: NHO 2006

available to the IW enterprises. By the end of 2005, more than 50 per cent of employees in Norway were working for an IW enterprise.

On a national level, the parties of the agreement set up a national coordination group and established close collaboration on the IW work.

### Common philosophy on Inclusive Worklife (IW)

During the term of the agreement, the focus was mainly on sickness absence and how to reduce it. Based on the provision that the solutions had to benefit all three levels, i.e. society, enterprise, and individual, the parties of the IW agreement had a common philosophy, which gave direction to their work.

Common  
philosophy

#### COMMON PHILOSOPHY OF THE IW AGREEMENT

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- The workplace is the best arena for finding solutions.
  - Problems and solutions must be closely linked, and only a small number of problems need to be "exported" to experts.
  - The best solutions arise from close dialogue between the employee and the employer. The employee "wears the shoes and knows best where they pinch", while the employer knows the opportunities for and the limitations on change. Both parties have a responsibility to ensure that close dialogue is geared towards finding a solution.
  - Sickness is a private matter, but sickness absence is a matter between employee and employer. All parties saw the need to change their attitude towards sickness absence.
  - Time is an important factor; the faster measures are put in place while an individual is on sick leave, the greater the chances of success.
  - Activity is a "medicine" for many types of illness. Staying away from the workplace to recover from an illness/ailment is not always the best solution.
- 

This philosophy was communicated by all parties of the agreement. Halfway through the term of the agreement, a

Evaluating alternatives to passive sick leave

new practice for handling sickness absence was drawn up, in which the role of the doctor and that of the employer were changed in line with the philosophy. Amendments were made to the law and the new practice entered into force on 1 July 2004. As a result, the employer, the employee, and the doctor were required to evaluate alternatives to passive sick leave, with sanctions being placed on all three parties if the new practice was not adhered to.

Doctor's assess employee's capacity

In brief, this means that the doctor has to assess the employee's capacity to function and a new doctor's certificate is drawn up. Doctors who fail to adhere to this could lose their right to issue a certificate.

Employer initiates dialogue

Besides, the employer is to initiate dialogue with the employee and consider alternative areas of work. If the employer fails to do so, he risks being fined.

Employee must co-operate

Finally, the employee must co-operate with the employer to find alternatives. If the employee fails to do this, he could lose his sick pay.

### Results of the IW work

The IW agreement was evaluated twice by a number of research environments. The midterm evaluation of the agreement, in 2003, showed that it was unlikely that the operative objectives would be reached during the term. Sickness absence rose between 2001 and 2003. Nevertheless, the parties chose to proceed with the agreement because, among other things, the evaluation had shown that the work on health, safety, and environment had been vitalised among the IW enterprises; that the level of co-operation in the enterprises had improved; and that the first enterprises to have signed the IW agreement had begun to see results in the sickness absence. This trend increased in 2004, and in the second half of 2004, a new practice on sick leave was received, which boosted the trend further. By the end of the term in 2005, sickness absence had reduced on a national level by 10 per cent compared to 2001, while the majority of the private sector had achieved the objective of a 20 per cent reduction in sickness absence.

20 per cent reductions in private sector

Constructive attitude

Also, attitudes towards sickness absence have changed. Absence is no longer perceived as a private matter between the employee and doctor, but is also a matter for the employer and the employee to discuss and find possible solutions. Sickness absence first being solved at the workplace through

dialogue and not passed on to experts until it proves essential, has turned out to be an important element of the success of Norway's IW agreement.

Another important result of the work with IW is the vitalisation of the work on health, safety, and environment in enterprises, especially the psychosocial work environment. Evaluation reports show that the level of conflicts has been reduced, both between employees and between employers and management.

Fewer conflicts

With regard to retaining or recruiting persons with impaired functional capacity, IW enterprises show better results than non-IW enterprises. The average national age of retirement went down during the term of the agreement, although the objective was to increase it. But a new pension reform has been agreed upon that could change this trend in the future.



The last quarterly report showed a small increase in the amount of sickness absence, mainly in the public sectors of healthcare and education. This means that the focus on IW must continue with a more practical guidance in both public and private sector in the future.

### New agreement

IW has proved strength

A new IW agreement has now been concluded between the parties and the authorities, running until 2009. IW has proved to be a good instrument for strengthening worklife, especially for halting the exodus from work to benefits. The objective of IW is ambitious and it has therefore been decided to stick to the same course of action and focus, but in order to reach more of the operative objectives, it should be assessed how the work can be strengthened both through inputs from the parties and through new measures from the authorities. Authorities, enterprises and individuals have benefited from those who are willing and able to work, when given the opportunity to do so.

It is important to increase the efforts through the same principles with an even better follow up in the companies and the public sector and by looking for additional tools to supplement today's practice in the work on IW. Finally, existing practice when people change status from sickness to permanently disabled should also be looked into.

## POLICY RECOMMENDATIONS

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Lessons learned from the Norwegian IW agreement make the Nordic business federations recommend:

- A successful cooperation between the public and private sector with both employer and employee organisations participating in periods with high levels of sick absence
  - The period of reduction in sick leave of about two years is not enough for final conclusions at this point—but this is certainly a model that the Nordic countries will look into in the years ahead
  - The lower average retirement age in the same period limits the strategy's success.
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## SWEDEN IN THE WORLD

# Globalisation through liberalisation

**Nordic countries have some of the largest public sectors in the world and thus some of the world's highest tax burdens. Therefore, in a globalised world it seems obvious to make sure that tasks solved by the public sector are solved efficiently.**

**Furthermore, many of the tasks that have historically been solved by the public sector can be solved more effectively by the private sector. Liberalisation has been part of the Nordic countries' strategy for increased quality and efficiency. In this regard, Sweden is a Nordic forerunner.**

It is essential for economic development that public services are provided as cheaply and efficiently as possible. Competition in the provision of public welfare services can contribute to a more resource-efficient handling of jobs.

Public service should be solved efficiently

Competition and liberalisation of tasks that have traditionally been solved by public suppliers can add efficiency to product and service markets and at the same time give lower prices. The Swedish liberalisation process has been a vital injection for the Swedish economy, resulting in more efficient product and service markets and thus higher productivity.

Competition and liberalisation adds efficiency

### Swedish liberalisation process of the 1990s

Before the 1990s the Swedish economy was characterised by low productivity growth and high consumer prices. One reason was the lack of competition, mainly due to legislative and regulative matters restraining new companies to enter several markets.

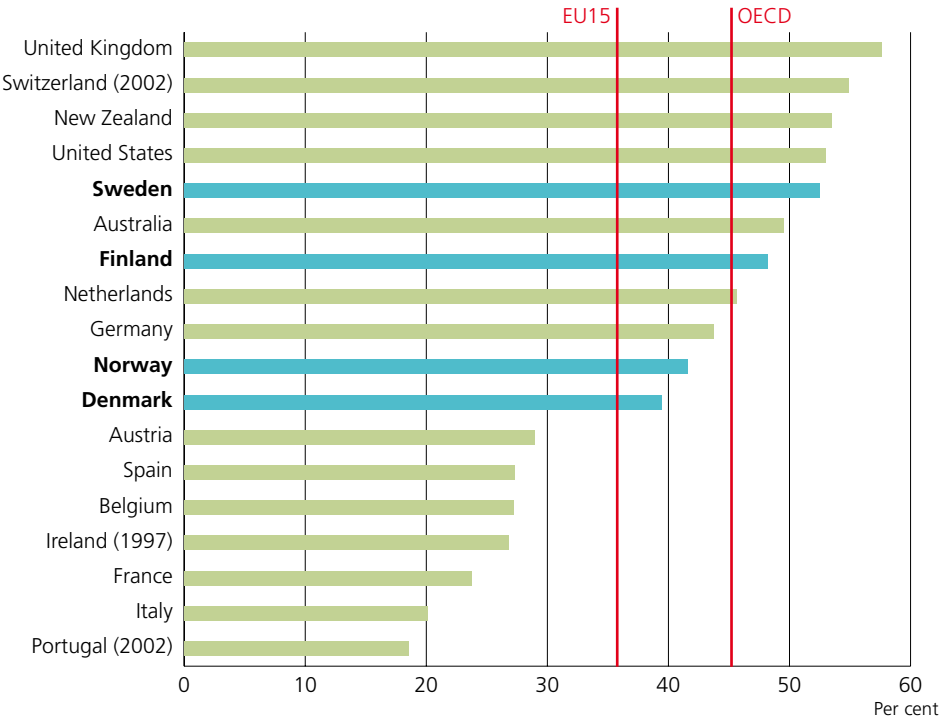
Low productivity due to lack of competition

In 1993 the Swedish competition law was harmonised with the EU-legislation. Furthermore, a liberalisation process started, implying dynamic changes in the Swedish economy,

Three main ingredients



GOVERNMENT USE OF PRIVATE SUPPLIERS, 2003



Source: Government Financial Statistics 2005 and DI calculations

fuelled by the economic difficulties of the time. Some of the most important deregulations took place in the transport, communication, and energy sectors. During this period Sweden also introduced a so called “free-school system”. The liberalisation process has been characterized by three main ingredients: abolishment of state monopolies, replacement of barriers to entry by freedom of establishment, and deregulation of price regulations.

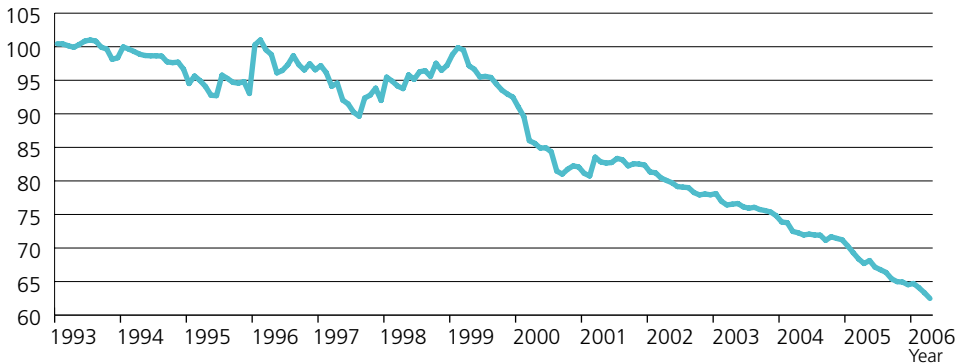
Telecommunication

From 1 to 170 operators

The telecommunication market was liberalised in 1993–1994 with the introduction of a Telecommunications Act and the transformation of the public monopoly Televerket into a state-owned public limited company (Telia). During the past decade the number of operators has increased from practically one operator in the early 1990s to around 170 fixed telephone operators and almost 100 mobile telephone operators. However, the fixed telephone operators are still dependent on Telia’s copper access network to reach households.

## TELEPHONE SERVICES AND EQUIPMENT

Real prices, index 1993=100



Source: Statistics Sweden

One significant effect of the deregulation of the telecommunication market is the past decade's trend of falling prices. Since 1993 real prices in the sector have decreased by more than 35 per cent. Even though technological progress has pushed prices downwards internationally, there are few countries in the world where international phone calls are cheaper than in Sweden.

Falling prices

## Electricity

Prior to the deregulation of the electricity market, power producers and/or independent distributors were organised into local monopolies, and electricity customers were not able to change electricity supplier. The electricity market was opened up for competition in 1996, introducing freedom of establishment in electricity production, trade with electricity, and a common market for electricity with Norway (Nord Pool).<sup>7</sup> In 2000 Nord Pool was expanded to Finland and Denmark as well, and gradually the electricity market is expanding to encompass more European countries.

Between 1990–1995, total factor productivity in Swedish electricity production fell by 16.9 per cent. This was followed by a 19 per cent increase in total factor productivity during the years after deregulation.<sup>8</sup> The deregulation is estimated to have reduced prices by around 10 per cent in the electricity production and electricity resale stages, which account

19 per cent increase  
in total factor  
productivity

for around one third of total household electricity costs.<sup>9</sup> Approximately half of the Swedish households have so far switched electricity supplier or renegotiated the terms with the previous supplier.<sup>10</sup> Since 1996 electricity prices have actually increased in real terms in Sweden. The price increases can, however, to a large extent be explained by political decisions to restrict nuclear energy production and increases of approximately 150 per cent of the energy tax.<sup>11</sup>

### Postal sector

50 per cent  
price reduction

The postal sector was deregulated in 1993, but continue to be an oligopoly market. New challengers have gained only five per cent of the market share and the earlier monopoly holder, the state owned company Posten AB, still controls over 90 per cent of the total letter delivery market. The deregulation mainly resulted in an opening up of the market for large mail shots in metropolitan areas, where prices have dropped by almost 50 per cent in real terms since deregulation. The market for individual postal items is still, de facto, monopolised by Posten AB. Average real prices in the postal market have been reduced by 5–10 per cent. Labour productivity is estimated to have increased by 30 per cent in the state owned Posten AB between 1993 and 2000, most likely as a result of the increased competition.<sup>12</sup>

30 per cent  
increase in labour  
productivity

### Air traffic, the rail market, and the taxi market

More and cheaper  
operators

Domestic air traffic was deregulated in 1992. The reform gave any Swedish airline the right to operate domestic routes. The prohibition against foreign airlines to operate domestic flights in Sweden was removed in 1997. From a situation with virtually only two domestic flight operators in 1992, there is now a greater degree of competition, not least from upcoming low budget companies.

Lasting sole right

The rail market has been deregulated in some segments, such as the regional and the unprofitable interregional passenger traffic. However, the state owned SJ still has the sole rights to profitable interregional passenger traffic and existing freight traffic, even though pricing is unrestricted. Prices have fallen by approximately 20 per cent in the deregulated segments and the new competitors share around 50 per cent of the market. On the other hand, prices for all rail passenger traffic have increased by 20 per cent, although the unregulated segments weigh heavily in this price index.

## A free-school system

Since 1992 there has been a system of, in principle, free entry of private schools, financed by public money in Sweden (“the free-school system”). The private schools get a voucher from the municipality in which they are located for each pupil attending the school. The voucher consists of money from the specific municipality in which the school is located. The value of the voucher should in principle correspond to the cost per pupil in the schools run by the municipality.

Free entry of  
private school

To start a private school, permission has to be granted from the national school authority (Skolverket). The authority approves the application if the school can fulfil certain criteria concerning the goals and the content of the education, and the school budget etc. The administrators of the municipality, in which the private school is intended to be established, is invited to give an opinion to Skolverket about the establishment. It is rather common that the municipality finds that Skolverket ought to reject the application, due to the fear of pupils leaving the public schools. If too many pupils reject public schools, the administrators of the municipality fear that this would harm the fiscal stance of the municipality's school, due too less economics of scale. However, Skolverket hardly ever rejects an application on these grounds.



Higher quality in private schools

About five per cent of the pupils in Sweden, age 18 and below, attend private schools. An evaluation from 2005 from Skolverket of the “free-school system” shows that quality, measured as average marks after the ninth grade, is higher in private schools, also taking socioeconomic aspects into consideration. The study also shows that the higher the market share of the private schools in a municipality, the higher the average marks in the schools run by the municipality. Hence, there seems to be a positive effect on quality due to competition.

Liberalisation resulting in efficiency and productivity

### Conclusion

The liberalisation process has been a vital injection for the Swedish economy, resulting in more efficient product and service markets and thus higher productivity. Several studies also show that this process has had a downward effect on prices. During the course of the 1990s the Swedish information and communication technology (ICT) sector advanced to a leading position in the world, together with the ICT-sectors in countries such as Finland, Ireland, and the US. This has been one of the most important factors driving Swedish economic growth during the past decade. It is a safe assumption that this would not have been possible without the, in an international perspective, early deregulation of key markets.

Still much to do

Even though the liberalisation process has been an injection to the Swedish economy with higher productivity and smaller price increases than would have otherwise been the case, there is still much to do. The service sector in Sweden, especially healthcare, schools, child care, and care of elderly, are still dominated by the public sector. More than 80 per cent of these services are never exposed to competition.

## POLICY RECOMMENDATIONS

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Lessons learned from the success of the Swedish liberalisation process lead to the following recommendations of the Nordic business federations:

- A successful global strategy requires that public services are solved efficiently
  - Productivity in the public sector can be increased through better management and competition
  - Many of the tasks that have historically been solved by the public sector can be solved more efficiently by the private sector
  - The Nordic business organisations would welcome a furthering of the Nordic liberalisation process
  - A natural step forward in this process is to open up for competition in the so-called welfare sector, which has traditionally been monopolised by the public sector
  - Liberalisation and deregulations open up new markets for private companies and entrepreneurs resulting in a higher degree of competition, which in turn tends to put a downward pressure on prices and an upward pressure on quality
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# Final remarks

With globalisation follows an increasing competition between countries when it comes to creating favourable conditions for companies and citizens that enable them to seize the opportunities of globalisation.

The five cases collected in this publication prove that Nordic countries' points of departure are different. Thus, due to the similarities as regards cultural bands as well as institutional structuring the cases clearly indicate that solutions are within reach when it comes to adjusting each country's framework conditions to globalisation.

This publication has focused on five important ingredients in a global strategy for winning:

1. A flexible labour market with strong incentives to work
2. An efficient innovation system that ensures dissemination of knowledge and know-how between knowledge institutions and businesses
3. A tax system that makes it attractive to work and do business in the Nordics
4. A clear strategy for reduced sickness absence in both the private and public sector in order to get the most out of the labour force
5. A strategy of further liberalisation and deregulations which open up new markets for private companies and entrepreneurs resulting in a higher degree of competition and overall productivity

If each Nordic country seeks inspiration in each others solutions in these five areas, the Nordic region will succeed towards the goal: To become the most competitive region in the world.



# Notes

- <sup>1</sup> Nordic Council and the Nordic Council of Ministers: Norden som global vinderregion, 2005.
- <sup>2</sup> IMD's survey of business managers' attitude to employment regulations (including redundancy regulations) shows that especially Danish employers appreciate labour market flexibility.
- <sup>3</sup> Roy Morgan International, Finding No. 3963—January 11, 2006.
- <sup>4</sup> Ennova: European Employee Index 2006, based on responses from 5,500 randomly selected Danish citizens, May 2006.
- <sup>5</sup> Finland leads the OECD countries when calculating the average of 29 indicators for knowledge and competence, e.g. R&D expenditures, knowledge transfer between universities and companies, interest in science and technology among youth, and patent productivity.
- <sup>6</sup> Beside the temporary surtax on income above a certain level (corresponding to annual income of 53,643 euro for the year 2005), there is only one tax bracket. For income earned in 2005 the rate was 24.75 per cent to the central government and an average of 12.98 per cent to the municipality or a combined tax rate of 37.73 per cent. Taxable individuals are entitled to a personal tax credit corresponding to 4.223 euro per year. Payable income tax is determined by multiplying income with the tax rate and then deducting the amount of the fixed tax credit.
- <sup>7</sup> The network operation was, however, considered a natural monopoly that was to be regulated and supervised by the government.
- <sup>8</sup> Avreglerad elförsörjning. Ökad konkurrens och ökad effektivitet. Rapport 1 och Rapport 2, Projektrapport Dnr 105/1999, Konkurrensverket, A. Veiderpass, 2004.
- <sup>9</sup> Lärobok för regelnissar—en ESO-rapport om regelhantering vid avregleringar (Ds 2002:21), Mats Bergman.
- <sup>10</sup> Avregleringen av sex marknader, Mål, medel och resultat, Statskontoret, 2004.
- <sup>11</sup> Konkurrensen i Sverige 2004, Konkurrensverket.
- <sup>12</sup> Samhällsekonomisk analys av effekterna av liberaliseringen av postmarknaden—Underlag och överväganden för Post- och kassaserviceutredningen. ITPS-rapport till Post- och kassaserviceutredningen, B. Falkenhall and A. Kolmodin, 2004.