In 1985, political scientist Peter Katzenstein published a concise study entitled *Small States in World Markets*. The argument he raised, much against the dominant vein of research at the time, was that certain small and collectivist European countries enjoyed comparative advantages in the international economy. The study took particular note of the Nordic region, which seemed to combine a large public sector and redistributive policies with successful private enterprise. Moreover, the relationship between the public and private sector was not merely a case of peaceful coexistence, but rather social equality, corporatism, and the welfare state were important *causes* of economic success, according to Katzenstein’s claim.¹

When it comes to economic policy, the Nordic model of social democracy rests on three essential pillars: tripartite *concertation*² (rather than confrontation) between the state, employers, and trade unions; a *comprehensive welfare state*; and an *activist industrial policy* construed to sustain a skilled labour force and a favourable fiscal environment.

As for the dynamic between employers and trade unions, centralized negotiations provide for moderate wage settlements, which in turn have helped to keep inflation low and thus contributed to a competitive private sector. Meanwhile, the high rate of participation in the labour market in the Scandinavian countries ensures a broad tax base among employees, which has made it possible to fund an extensive system of social security. This welfare state, finally, is geared towards sustaining a qualified and mobile labour force, which relates to the third and final pillar: an industrial policy where a flexible labour market is backed up by a robust safety net and search for competitive advantages.

The core of Katzenstein’s argument is that the Nordic model permits a combination of security at home and competition abroad. Openness
means opportunities, but also exposure to the fluctuations of the global economy. The risks entailed by competition have therefore been mitigated by welfare arrangements which ensure that aid is provided when work is lost or changes hands. The Nordic model thus represents a rare integration of liberty and security, aimed to benefit all classes rather than merely redistributing wealth to the poor.

In scholarly debates, these observations raised a few eyebrows at the time that *Small States in World Markets* was published. A common assumption among American economists, for example, was that Norway, Denmark, and Sweden were static economies incapable of innovation and characterized by excessive regulation, high taxes, and low productivity.³ Katzenstein suggests that, on the contrary, the heavy presence of the state had a stimulating effect on the economy. A particularly striking point was the role of the state as a mediator between the social partners and a driver of research and innovation. To economists leaning upon the principles of small state and free enterprise, these observations gave a glimpse of a very different world.

The unusual character of Katzenstein’s account is a telling illustration of how the relationship between the public and private sector (and between employers and trade unions) has been of a particular nature in the Nordic countries. The model captures the essence of a social democratic vision of society, but historically it is grounded in a broader cross-party compromise. Its foundation was laid in the interwar era, when the accommodation between the labour movement and the agrarian parties in each of the Scandinavian countries paved the way for political stability, as discussed in Chapter 3.

Thus, where the 1920s had been conflictual and unpredictable, the 1930s served to pull the three Scandinavian countries towards a common path of compromise and coalition. Behind the structural reforms was an emerging ideological consensus on the basic principles of work as well as welfare. Negotiation between social partners was one reflection of this consensus, while the steady expansion of welfare rights after 1945 was another. Both aspects were more deeply embedded following the end of the Second World War. In this chapter, we will look closer at the main features of the relationship between state and market as it has evolved in Scandinavia.

**Wage equality and high investment**

A key characteristic of the Nordic model is the comparatively small wage differentials. Restraining inequality, rather than effecting a