Pattern bargaining as a means of wage coordination in the Nordic countries

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Speech at the launch event of the Nordic Economic Policy Review 2025, Ministry of Finance, Helsinki 250507.

Thanks first for the invitation to speak here and for having been asked to write one of the contributions to this issue of the *Nordic Economic Policy Review*.

This is particularly nice for me, since I was the chair of the Economic Council in Sweden when it in 1994 started the *Swedish Economic Policy Review*, which later was transformed into the *Nordic Economic Policy Review*. I served as editor in 2017–19, so I am happy to see that the review is still live and kicking. Now with my Finnish colleagues Roope Uusitalo and Antti Kauhanen in charge.

My contribution is about a particular trait of the *Nordic model of wage formation*, the strong coordination based on international-competitiveness concerns. This has a long tradition in the Nordics, because all the economies are heavily dependent on foreign trade.

Earlier, these international competitiveness-concerns exercised their influence through centralised bargaining between peak-level organisations. But over time, the model has changed into one of *pattern bargaining*, with the manufacturing sector as a representative of the internationally competitive sector – the export sector or as I prefer to call it the *tradables sector* – concluding the first agreement in a wage round, this way determining the norm for wage increases in the whole economy.

There is a strong belief among most practitioners that this model promotes wage moderation and good macroeconomic performance.

First a few words about pattern bargaining in the various countries. The model is firmly established in Denmark, Norway and Sweden since the late 1990s. Finland is different: here centralised bargaining – involving also the government – stayed on longer and the bargaining system still seems to be in some form of transition.

The similarities between pattern bargaining in the various countries are great. So it is appropriate to talk about a Nordic model, although Danes prefer to call it the Danish model, Norwegians the Norwegian model, and Swedes the Swedish model. And though Finland is a latecomer to this form of bargaining, you speak about the Finnish model.

Still there are differences:

- Peak organisations continue to play an important coordination role in Denmark, Norway and Sweden. The role is greatest in Norway, where they still occasionally conclude the agreements.
- In Denmark and Norway, governments are still sometimes involved in the bargaining, whereas this does not happen any more in Sweden and Finland.
- Mediation institutions are important for upholding the manufacturing norm: they have the strongest role in Denmark where in case of a conflict in some bargaining area they can link the mediation proposal with all other private-sector agreements into one overall voting procedure.
- In Denmark, Finland and Norway, the wage norm refers to *total* wage increases, including wage drift. In Sweden it only refers to wage rises in the industry agreements.
- In Denmark, Norway and Sweden, public-sector wage increases follow the manufacturing norm, whereas this is contested in Finland.
  - In Denmark there is even a system for ex-post regulation to achieve this, that is to correct public-sector wage increases if they deviate from the norm.
  - In Sweden, the manufacturing norm is followed also in figureless wage agreements, which are common for white-collar workers in the public sector.
- Local bargaining is important in all the countries, but most so in Denmark and Norway, where the bulk of wage increases are negotiated locally, which is not the case in Sweden and Finland (except in the forest industry).

What has been the outcome of wage bargaining? Up to 2022, the wage share of value added in manufacturing has remained more or less constant in Norway and Sweden. This would seem to reflect wage rises in line with unchanged international competitiveness. In 2023, there was a fall indicating stronger competitiveness, associated with the large currency depreciations in these years.

In Finland, the wage share rose substantially in 2008–12, indicating weakened competitiveness. But this was followed by an almost equally large fall, so that the wage share has remained more or less constant over the period shown.

In Denmark, the wage share has fallen very much, but this partly reflects a shift in composition of output towards high-profit sectors.

Overall, the graph indicates wage formation in line with international-competitiveness concerns in all Nordic countries.

One gets a similar picture from unit labour costs measured in euro. Increases in all Nordic countries have been in line with or lower than in the euro area over the 2000–23 period. Sweden stands out with a large fall. This depends on both high productivity growth and the depreciation of the krona.

A final indication of strong international competitiveness is the large trade surpluses in Denmark, Norway and Sweden. But the Finnish situation is different.

The standard informal argument for why pattern setting by the tradables sector promotes wage restraint is that foreign competition restricts the possibilities to raise prices there. This argument is easiest to see with a credible fixed exchange rate as in Denmark or with the common euro currency as in Finland.

But the argument has also been made with a flexible exchange rate and an inflation target as in Norway and Sweden. It is then often claimed that there is a *double incentive* for wage restraint: the same incentive as in the fixed-exchange-rate (or common-currency) case + an extra incentive because the central bank will react to wage increases threatening the inflation target by raising the interest rate. This causes the exchange rate to appreciate, and thus additional falls in profits and employment in the tradables sector, thus raising the costs of excessive wage rises there.

I don’t find this reasoning obvious. Exchange rates are notoriously hard to forecast: there is also the possibility of a depreciation when wages rise excessively because of purchasing-power-parity thinking in the foreign-exchange market. And in an inflation-targeting regime, the non-tradables sector, too, has strong incentives to avoid excessive wage rises as interest-rate reactions by the central bank hurts it directly by restricting demand. This is probably more certain than a currency appreciation.

In *formal theoretical modelling*, it has been hard to build a case for wage leadership by the tradables sector giving more wage moderation than other arrangements. This holds in analyses by Anna Seim and myself, Petteri Juvonen and Juhana Vartiainen (in his earlier capacity as an economist, which I take it he is now returning to).

The result is rather that it is norm setting per se that promotes wage moderation, irrespective of who is doing it. The mechanism is that the pattern setter has an incentive to avoid excessive wage rises, because she herself will be hurt when other sectors choose the same excessive wage rises.

A difficult question is why the pattern setter's wage norm is followed by other sectors. I can think of three possible reasons:

- Wage setting is a *repeated game*. Defectors from the norm can be punished in the future, because coordination then is likely to break down which will hurt them.
- There are punishment strategies outside the usual way of economic modelling. I have met seasoned public-sector wage negotiators who burst into tears when describing how they were bullied by colleagues in manufacturing when they tried to exceed the norm.
- Or it could be, as in Anna Seim's and my analysis, that the combination of comparison thinking and so-called loss aversion (that is in this case disutility from lower wage increases than for other groups), provides strong incentives to emulate the wage increases in the leader sector. In our analysis, there are favourable high-employment outcomes if norm setting is done by a small rather than a large sector. This squares with pattern setting by the tradables sector, which is smaller than both the non-tradables and the public sector, but this has nothing to do with foreign competition as in informal reasoning.

Why has the manufacturing sector become the pattern setter? There are likely historical reasons: traditionally high organisation rates on both the union and the employer side and high coverage of collective agreements have given the sector *legitimacy* to perform this role. And the sector has – at least in Denmark, Norway and Sweden – built the *operational capacity* to do this.

What about the future of pattern bargaining? I believe it will face important challenges. The reason is the inherent *status-quo bias* of the manufacturing sector's norm setting. It serves to preserve the current size of the tradables sector.

This aim is likely to come into conflict with needs of labour reallocation. First, ageing populations imply both rising labour demand in the health and care sector and stagnating aggregate labour supply. Second, rising defence expenditure means higher demand for military personnel.

To some extent these challenges can be met by labour reallocation within the public and nontradables sectors. But this will probably not be enough. Reallocation of labour from the tradables sector is likely also required. This may be impeded by a rigid application of pattern setting by the tradables (manufacturing) sector.

Instead, both wage rises in the tradables sector that shrink labour demand there and relative-wage increases in the public and publicly financed sectors to attract labour may be needed. The challenge will be to square this with continued responsible wage formation.

I don't know how this will be done. In *Sweden*, public-sector unions in the mid-2010s managed to raise relative wages of their members through figureless central agreements leaving wage determination to the local level. But recently, the process has gone in reverse, with private-sector wages rising more than public-sector ones. And there is strong resistance from manufacturing to any modifications of the current system.

In *Denmark*, there was in 2023 a tripartite agreement where the government provided local governments with extra funds for wage increases in excess of the ordinary collective agreements in order to make work in welfare services more attractive.

In *Finland*, municipal-sector unions after a labour conflict negotiated a wage programme with wage increases above the norm, which have just been confirmed in the collective agreements concluded last week as I understand it.

As I take it, the best way forward is if labour market parties can reach a consensus on future pattern bargaining which combines aggregate wage moderation with the flexibility required to handle needs of labour reallocation. Such a consensus should also involve governments, which will have to provide the funding for relative-wage increases in the public sector.

The challenges are similar in all the Nordic countries. In Denmark, Norway and Sweden, existing systems probably need to be reformed and made more flexible.

In Finland, I think you need to reach a stable new system that balances various requirements. I shall not give advice on this but only warn you from trying to copy the systems in the other Nordic countries in the belief that they are perfect. They are not. So, it will be wise of you also to do your own thinking.

Thank you! I end here.