

# Income Equality in the Nordic Countries: Myths, Facts, and Lessons

Based on BFI Working Paper 2025-25, “Income Equality in the Nordic Countries: Myths, Facts, and Lessons,” by Magne Mogstad, University of Chicago; Kjell G. Salvanes, Norwegian School of Economics; and Gaute Torsvik, University of Oslo

Income equality in the Nordic countries results from a severe compression of hourly wages that reduces the returns to labor market skills; this is achieved through a wage bargaining system with strong coordination within and between industries.

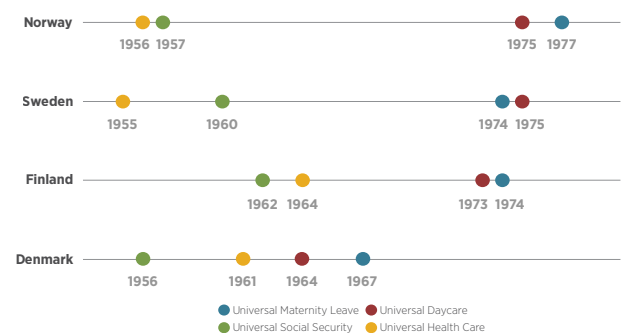
Recent calls for economic and social equality within developed countries, including the United States, have brought renewed attention to Nordic countries, where equality is often equated with such policies as subsidized and readily available daycare, generous parental leave policy, universal health care, free college, and strong labor rights and unions. If these countries can have low inequality and economic growth, the reasoning goes, so can we.

However, how well do these Nordic admirers understand the model employed by Denmark, Finland, Norway, and Sweden?<sup>1</sup> To replicate the Nordic experience, is it simply a matter of implementing certain policies? What explains the Nordic model? This paper combines theory and evidence to examine these and related questions, and to address the challenges for those hoping to emulate the Nordic experience.

Before describing the authors’ analysis, let us first broadly review the Nordic economies and what makes them distinctive. First, just 26 million people live in the four countries, with around 10 million in Sweden, roughly twice the size of the other

<sup>1</sup>This work focuses on the four largest countries of the Nordic Region, which in total includes Denmark, Norway, Sweden, Finland, and Iceland, as well as the Faroe Islands, Greenland, and Åland. Nordic countries are often conflated with Scandinavia, which typically refers to Denmark, Norway, and Sweden.

**Figure 1 •** Timeline of Introduction of Social Policies in Nordic Countries (1950-2000)

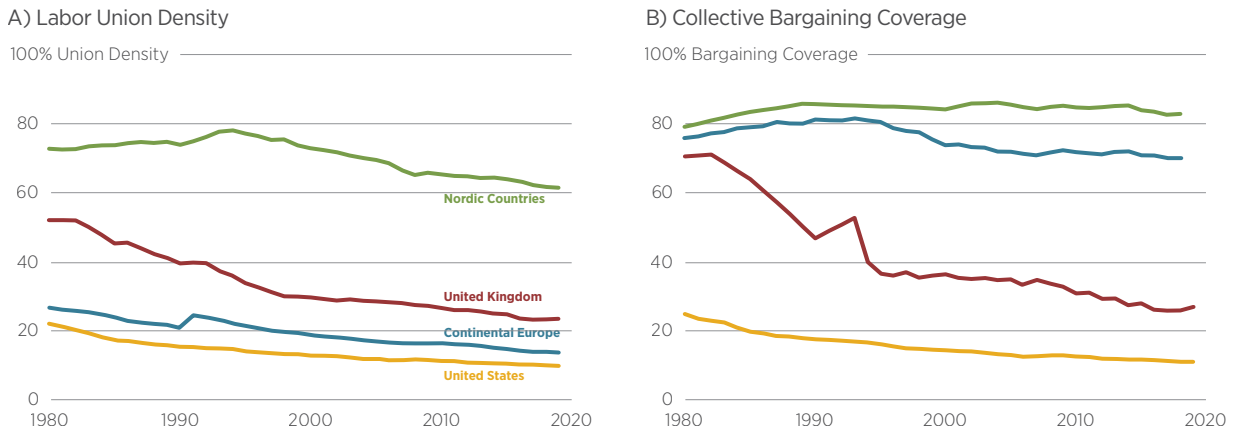


Note: This timeline represents the introduction of key social policies in the Nordic countries. Each point reflects the year a policy was enacted.

Nordic countries. Though commonly perceived as homogeneous, in 2021 both Norway and Sweden had proportionally larger foreign born populations than the United Kingdom and United States. Nordic residents are also relatively well-educated and healthy, and they enjoy life in countries with high quality-of-life indicators.

Finland exports just under 50% of its GDP, while the other three export half or more of the goods and services they produce. Finland’s exports include machinery, electronics, paper products, and chemicals; Norway’s exports are predominantly

**Figure 2** • Trends in Union Density and Bargaining Coverage



Note: This figure shows the fraction of union members (Panel A) and the fraction of workers covered by collective bargaining agreements (Panel B) between 1980 and 2020 for the United States and selected European countries. “Continental Europe” includes France, Germany, Spain, and Portugal, and “Nordic Countries” includes Norway, Sweden, Denmark, and Finland. As shown in Panel A, unionization varies widely across advanced economies, with the highest density rates in the Nordic countries reaching several times the lowest density rates in the United States. These differences expand from 1980 to 2018, as the share of U.S. and U.K. union workers has steadily declined over time.

oil, gas, and fish; Sweden exports a substantial amount of manufactured goods; and Denmark is a leading exporter of chemical products, particularly pharmaceuticals.

Average incomes in the Nordic countries are above the Organization for Economic Cooperation and Development (OECD) average and not far below the average income in the United States. Regarding GDP per capita (a key standard-of-living indicator), when this measure is decomposed for labor productivity (as proxied by GDP per work hour, and labor quantity as measured by work hours per capita), the Scandinavian trio (Denmark, Norway, and Sweden) is at least as productive as the United States, and considerably more productive than the United Kingdom and the OECD average.

Finally, on average, Nordic citizens work fewer hours per year than their OECD counterparts. Employment rates and labor force participation rates, though, are relatively high. Indeed, the employment rate in the Nordic countries is higher than those in the United Kingdom and United States, and the OECD average, a difference that largely stems from a higher rate of female labor force participation.

With that as background, what distinguishes the social and economic model of the Nordic countries? The authors offer the following four pillars:

1. Significant public investment in family policies, education, and health services;
2. coordinated wage-setting within and across industries;
3. substantial expenditure on social insurance to safeguard against income losses due to unemployment, disability, and illness; and

4. high and progressive taxation of labor income, complemented by subsidies for services that support employment.

These pillars are fully described in the working paper, and Figure 1 illustrates the development of core policies that address these elements. The range of services provided by these and other programs are meant, in part, to provide equality of opportunity. How successful are these programs? The authors present key facts while also debunking myths and misconceptions about income inequality in the Nordic countries, in comparison with the United Kingdom and United States, which both exhibit high levels of income inequality. They find the following:

- A more equal predistribution of earnings (for example, through minimum wages, access to education, and labor market regulations, among others), rather than income redistribution, mainly explains the lower income inequality in the Nordic countries.
- Equality in wage rates, not work hours, primarily explains lower inequality in the Nordic countries. This is largely driven by wage compression, meaning there is a small wage gap among employees, regardless of their position and seniority.
- Conventional wisdom aside, hourly wage compression *within* gender, not *between* men and women, is a key component of income equality in the Nordic countries. For example, although the gender gap in hourly wages is about 30 percent lower in the Nordics than in the United States, it explains less than 2 percent of the difference in the dispersion of hourly wages between the Nordic countries and the United States.

What explains these facts? The authors analyze three common hypotheses, giving prominence to the third:

*Governments spend heavily on children and families through subsidized daycare, education and health programs, thus equalizing the distribution of skills and human capital among children of disadvantaged families.*

**Reality check: Most research evaluating the causal effects of such programs suggests that effects are relatively modest. Indeed, the observed distributions of education and skills are relatively similar between the Nordic countries, the United States and United Kingdom. In contrast, the wage premium for education and skills is twice as large in the United States and United Kingdom.**

*Although the Nordics have relatively high- and progressive-income taxes, which might discourage labor supply, they also subsidize services that are arguably complementary to working, such as daycare and other family friendly policies. These policies may both increase labor force participation and reduce inequality in hourly wages.*

**Reality Check: A growing body of research reveals that the impact of subsidized services is small. For example, subsidized daycare mostly replaces other forms of out-of-home care used by working mothers, resulting in little to no increase in maternal employment or earnings. (The authors are quick to note that this is not an argument against such policies, as their benefits may exceed costs, even with minimal impact on income inequality.)**

*Income equality in the Nordics is primarily attributed to a two-tier collective bargaining structure, starting with sectoral bargaining of wage floors or base wages, followed by local bargaining at the firm level. Importantly, there is strong wage coordination both between and within industries.*

**Reality Check: The authors concur. Both theory and data suggest that this coordination significantly compresses the distribution of wages compared to the distribution of labor productivity, and this wage**

**compression explains most of the social equality within Nordic countries.**

With that mystery solved, another looms. What impact does coordinated wage compression have on productivity and growth? If other countries, including the United States and United Kingdom, adopted wage compression policies, would their economies remain as productive and strong? Here, the evidence is less clear. One view holds that the Nordics benefit because less-equal countries have more incentive to innovate and take chances, which redounds to the Nordics' benefit. If true, then if all countries followed the Nordic model, innovation would suffer, and economic growth would decline across the globe.

In contrast, another view holds that wage compression and social insurance stimulate innovation, productivity, and growth because, for example, they increase the cost of low-skilled labor and lower the price for high-skilled workers, thereby affecting the profitability of new technology and driving out inefficient firms. In effect, wage compression and social insurance serve as mechanisms for sharing risk and compensating workers affected by the negative effects of structural change, thus reducing social and political barriers to new technology, international trade, and competition in domestic markets.

Research has yet to resolve this puzzle, with most evidence either correlational or circumstantial. To adequately address these and related questions will entail advances in both theory and measurement, including a tighter connection between data and theory. Such a connection is missing in most labor economics, the authors argue, and they offer a critique of current research agendas, many of which focus on micro data to explain a part of the puzzle. Their own research prescription includes the development of models in which skills, labor supply (including international migration), capital investments, wages, and profits are determined simultaneously. Without such models, there is little hope of understanding whether the Nordic model is replicable, or even desirable.

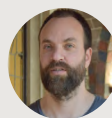
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