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# From Conflict to Cooperation: Norwegian Labour Market Institutions in the Making

**Jon Reiersen**

School of Business, University of South-Eastern Norway, N-3199 Borre, Norway; jon.reiersen@usn.no

**Abstract:** Moving a relationship of widespread conflicts and distrust into a virtuous circle of trust and cooperation is challenging, yet the case examined in this article shows that it is possible. A problematic start can indeed lead to a positive outcome. In the early twentieth century, Norway experienced the highest levels of labour conflict in Europe. Class conflicts were intense and often violent, with deep mistrust between the parties in the labour market. This situation changed markedly when the Norwegian Employers' Confederation and the Norwegian Confederation of Trade Unions signed the Basic Agreement in 1935. This agreement not only led to a lasting decline in labour conflicts, but it also marked a crucial early step towards a system of close collaboration between labour and capital in Norway. By focusing on the intimate relationship between beliefs, trust, and cooperation, this article explores how the labour market parties transitioned from widespread conflict and open struggle to a system of peaceful negotiations and compromises. Changes in beliefs enabled the parties to coordinate on a new cooperative equilibrium, an equilibrium that continues to characterise Norway's labour market today.

**Keywords:** beliefs; trust; cooperation; labour market institutions; industrial relations; Nordic model

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## 1. Introduction

Norway, together with its Nordic neighbours, often figures among the world's leading countries in various international rankings of social welfare, equality, happiness, public health, individual freedom, trust, and other social outcomes usually associated with a good society. At the same time, the Nordic countries are affluent, they are open to international competition and trade, and the pace of innovation and technological modernisation is high. Since the Nordic experiences seem to speak against the notion often expressed by economists that there is an inevitable conflict between economic efficiency and social equality, the Nordic countries represent attractive case studies for many scholars. Under the appropriate configuration of institutions and policies, equality and efficiency are possible to reconcile (Andersen et al. 2015; Barth et al. 2015; Calmfors 2014; Martin and Dølvik 2015; Moene 2013; Ocampo and Stiglitz 2018; Kenworthy 2019; Lindert 2021; Sandbu 2020).

Several studies have also recognized that the cooperative and trustful industrial relations present in the Nordic countries have been decisive in producing and maintaining the rather unusual combination of capitalist dynamics and high social protection (Dølvik and Oldervoll 2019; Engelstad and Hagelund 2015; Hvid and Falkum 2019; Moene and Wallerstein 2006; Nymoen 2017; and Swenson 2002, among many others). The core of what is often termed the Nordic model is a high level of collective organization among both employers and employees. Well-organized employers and employees have, over time, developed a system of labour relations that promotes high productivity and technological modernisation through a consensus-oriented model of decision making, but without sacrificing a fairly egalitarian distribution of results. The Nordic working life model is firmly anchored in a shared worldview based on the idea that cooperation between labour and capital leads to a sound economy, at both the company and national levels (Hvid and Falkum 2019; Løkken et al. 2013).

An issue that has been far less studied, however, is how and why these trustful cooperative industrial relations evolved in Norway. Although the strong cooperation between employers and unions on production and distribution are a core element of Norway's working life model today, Norway's labour market has not always been an arena for mutual respect, peaceful negotiations, and sound compromises. In fact, Norwegian industrial relations grew out of extremely difficult circumstances.

In 1935, the Norwegian Employers' Confederation (NAF) and the Norwegian Confederation of Trade Unions (LO) signed the famous "Hovedavtalen" (the Basic Agreement)—an agreement that laid down rules and codes of conduct for handling conflicts of interest between employers and trade unions at both the national and workplace levels. Although the Basic Agreement has been altered throughout the years, it still plays a central role in regulating the relationship between employers and trade unions in Norway. (For readers outside Norway, note that NAF became a part of the Confederation of Norwegian Enterprise (NHO) in 1989 through a merger.) It is well recognized that the Basic Agreement represents a critical early step towards a system of close collaboration between labour and capital (Bjørnson 2003; Bergh 2010; Hvid and Falkum 2019). However, it is also well recognized that the signing of the Basic Agreement marks a somewhat surprising turning point in the history of labour relations in Norway (Bergh 2010; Olstad 2019; Seim 1972).

The period prior to 1935 is often labelled "the period of conflict and struggles" by Norwegian historians. Norwegian unions were well known for their radicalism and militancy, but the employers were equally confrontational in defending their interests through the massive use of lockouts. In fact, no country in the Western world had a higher level of industrial conflict than Norway between the world wars (Hibbs 1978; Paldam and Pedersen 1984). The relationship between the unions and the employers was in no way characterised by trust, cooperation, and compromises—concepts that are often emphasized today when the Norwegian model of industrial relations is described. What enabled the transition from intense conflicts, mistrust, and open class struggle to the trusting and lasting cooperative relationship that the Basic Agreement of 1935 represents? This article addresses this question.

Overall, this article aims to contribute to two strands of literature. *First*, it contributes to the literature on the evolution of trust and cooperation in society and in interorganizational relationships more generally. As is well known, trust is important for society to function well (Algan and Cahuc 2013; Cook 2001; Fukuyama 1995; Hardin 2006). Trust makes potential partners more willing to cooperate in strategic interactions and to secure joint gains. However, far less is known about how a situation of distrust and conflict can be transformed into a system of trust and cooperation. Initial conditions characterising interpersonal and interorganizational relationships affect the development of these relationships at later stages. It is well documented that low levels of trust and cooperation in the early stages usually trigger dysfunctional spirals of distrust that can be very difficult to stop (Hoff and Stiglitz 2016; Kydd 2005; Rothstein 2000). Conflict and distrust generally breed more conflict and further distrust. Moving a relationship of distrust and conflict into a circle of trust and cooperation is, therefore, challenging. The case examined in this article illustrates, however, that initial distrust and conflict do not always lead to further distrust. A problematic start can lead to a positive outcome. *Second*, this article contributes to the history of labour relations in Scandinavia, and in Norway in particular. How did the labour market parties manage to move away from widespread conflict and distrust to an arrangement of peaceful negotiations and cooperation—an arrangement that has been absolutely decisive for the development of the Norwegian welfare society?

The rest of this article is organized as follows. In the next section, I argue that the situation the parties of the labour market in Norway faced before 1935 can be fruitfully analysed with the concepts of path dependence, beliefs, and trust. I start by briefly describing Norway's labour market between the world wars, demonstrating that this period was indeed marked by highly problematic industrial relations and extensive conflicts. This is used as a background for specifying in more detail the strategic situation the parties

faced. Section 3 shows that, although the parties of the labour market carried with them historically created beliefs that made cooperation difficult, several critical events between the world wars challenged and transformed these beliefs. In Section 4, I claim that these changes in beliefs, shaped by changes in the economy and in politics, led the parties to move away from conflict as their main strategy and to seek cooperation. These cooperating efforts culminated with the signing of the Basic Agreement in 1935. A new equilibrium in the game between the trade union confederation and employers' confederation was established—an equilibrium that still applies in Norway's labour market. Section 5 concludes the article.

## 2. The Problem of Trust and Cooperation

The analysis offered in this article draws on the works by Rothstein (2000, 2005), Hoff and Stiglitz (2016), and Basu (2018), who developed a framework to understand how historically created mental models and beliefs shape individual and collective behaviour. As Hoff and Stiglitz (2016) noted, with clear applicability for the case studied here, "Past social experiences and past social structures can result in sustained ways of conceptualizing a situation, and hence, sustained beliefs and social outcomes—for example distrust . . . or a pattern of aggressive responses to disputes" (p. 26). As will be further discussed, cooperation is difficult without trust and trust is closely related to beliefs. If members of a group have felt mistrust towards another group over a long period of time, it can be very difficult to persuade those members to start trusting the other group. This was basically the situation that characterised the relationship between the Norwegian Employers' Confederation (NAF) and the Norwegian Confederation of Trade Unions (LO) in the early twentieth century.

Because of the many years with conflict, LO and NAF shared a common view that struggle and conflict was the rule rather than the exception. However, the parties' perceptions were not only formed by the many years with conflicts. As Shiller (2019) demonstrates, narratives affect individual and collective behaviour in important ways, and the dominant narrative that circulated among union members in the early twentieth century was that struggle against (and not cooperation with) the exploitative capitalist class was the main vehicle for improving the conditions of the working masses. This struggle would not end before the unjust class society was abolished and a new social order was established. Within this interpretive framework, cooperation with employers implied the legitimization of an opposing party whose removal was actually desired. At the same time, it was difficult for the employers to accept an opposite party that believed their existence was undesirable. The dominant narrative among the employers was that, by accepting trade unions as a legitimate negotiating partner, this would in the long run pave the way for the socialization of the means of production. With this background, it is not surprising that the general view among Norwegian historians is that the signing of the Basic Agreement in 1935 marks an extraordinary turning point in the history of labour relations in Norway (Olstad 2019).

### 2.1. Struggle, Conflict, and Mistrust

As noted, Norway's labour market had been through extremely conflict-filled years before the Basic Agreement was signed in 1935. In the 10-year period from 1925 to 1935, there were just as many work conflicts in Norway as in the 50-year period from 1945 to 1996. The conflicts often lasted long and involved many workers. This is reflected in the loss of workdays in this period, as illustrated in Figure 1. From 1921 to 1931, 22 million workdays were lost from strikes and lockouts. The corresponding figure for the 10-year period between 1951 and 1961 was just under 2 million and only 400,000 from 1962 to 1972.

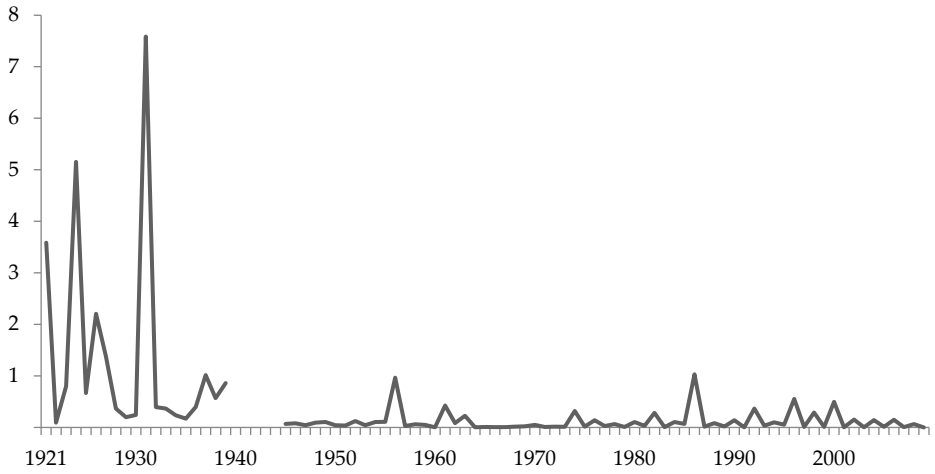



**Figure 1.** Workdays lost due to labour conflicts in Norway. Note: The vertical axis shows workdays lost from strikes and lockouts in millions. Source: Statistics Norway (1995, 2016).

Stagnating production, high unemployment, and falling prices—created mainly by a tight monetary policy and a strong commitment from the central bank to bring the Norwegian krone back to its prewar values (parity policy)—were the main causes of many of the conflicts in Norway between the world wars. The unemployment among trade union members increased from 2.3% in 1920 to 25.4% in 1927. From 1931 to 1935, the unemployment in Norway averaged 29% among trade union members (Statistics Norway 1995). Except for the years from 1923 to 1925, the prices in Norway fell continuously from 1920 until 1934, the year before the Basic Agreement was signed. With steadily increasing unemployment and falling prices, the employers demanded huge cuts in nominal wages—cuts that were very difficult for the trade unions to accept.

The year 1931 was particularly filled with conflict, created exactly by the employers' demand for deep cuts in wages. When the Norwegian Confederation of Trade Unions (LO) did not comply with this, the employers announced a big lockout. The lockout lasted for 5 months and led to the loss of 7.6 million workdays. LO interpreted the intention of the lockout as being to "... force the entire union movement to its knees" (Bjørgum 1985). The economic downturn with record-high unemployment had weakened LO. The strike funds were almost gone, and the employers were fully aware of this. In addition, the employers had a politically strong position. The political right had secured a majority at the general election in 1930, and the dominant conservative press massively agitated against "the union monopoly" and "union tyranny".

The year 1931 also marked one of the most dramatic events in Norway's modern labour history, the Battle of Menstad. It started with several thousand union members demonstrating with demands to stop what they considered to be strike-breaking at the warehouse and offloading place at Menstad. The police were called to stop the demonstration, but were chased away. The government therefore decided to send in armed troops against the workers. This decision was made even though the government knew that military troops called in as backups for the police had killed five workers in a similar incident in Ådalen, Sweden, just 4 weeks before the Menstad conflict. The Battle of Menstad garnered huge symbolic importance (as did the Ådalen shootings in Sweden). For many within the trade union movement, the event confirmed that the workers' interests could not be secured by cooperating with the employers. Fundamental changes in society were needed. This viewpoint was also publicly expressed by the Labour Party, who was (and still is) the closest ally of the LO. The Labour Party adopted the following statement at its party conference in 1930: "The labour movement must have complete freedom to act against the capitalist class and the capitalist state. The party therefore opposes every form of cooperation between classes ...". This statement was written and approved only a few

years before the Basic Agreement was negotiated between the Norwegian Confederation of Trade Unions and the Norwegian Employers' Confederation (NAF).

There were also several large conflicts in the years before 1931 that created difficulty in explaining how the parties of the labour market could unite behind a comprehensive cooperation agreement in 1935. The years from 1921 until 1928 were particularly turbulent. Large segments of Norway's working class had been highly radicalized after the Soviet revolution in 1917. In this political setting, the employers' main goal was to defeat the radical opposition within the LO. NAF strongly feared the consequences of an increasingly politicized labour movement, and were, therefore, in close contact with the government to gain assurances that the military would intervene in any illegal actions taken by unions. The government gave this assurance. They publicly stated on several occasions that they would intervene with force and that they were well prepared for a full confrontation with the labour movement if necessary. NAF and the government supported each other in an alliance of political and economic power (Knutsen 1985).

Knowing they had the government on their side, the employers became increasingly proactive. They demanded huge cuts in wages—cuts impossible for the unions to accept. In 1921, for example, sailors were faced with a demand for a substantial nominal wage cut, which meant a significant reduction in real wages despite falling prices. LO was convinced that other groups of workers would face similar demands if the sailors gave in. To protest, LO took almost all its members out on a sympathy strike. However, the employers had no problems recruiting strike-breakers, and violent confrontations arose between the strikers and strike-breakers in several places throughout Norway. The police and the armed forces were called in to protect the strike-breakers, and later, the government also passed new laws to protect strike-breakers. The general strike had to be broken off after several weeks and ended with an absolute defeat for LO. Many did not receive their jobs back after the strike, and LO lost 36% of its members. The conflict led to intensified bitterness, not just between LO and NAF, but also between LO and the government.

The tension between LO and NAF continued with more strikes and lockouts throughout the 1920s. The source of these conflicts was mostly the demand by NAF for substantial wage cuts. Small local conflicts were often expanded to wide-ranging lockouts, which severely drained LO's strike funds. The employers hoped that the pressure would be so great that LO would eventually capitulate and accept the wage cuts. However, LO demonstrated a greater ability to refuse the cuts than the employers had initially counted on (Dahl 1981).

The government tried to intervene and to help the parties settle for a compromise on several occasions, but without succeeding. Instead, they demonstrated that they were more or less powerless in preventing labour conflicts from developing. In the late 1920s, the antagonism, bitterness, and mistrust between the parties had intensified to the point at which the government decided to withdraw entirely from the wage-bargaining process. In the early 1930s, the parties of the labour market were left more or less alone to decide on future agreements (Falkum 2015).

### *2.2. A Game Theoretical Interpretation*

Because of the many years with conflict, LO and NAF carried historically created beliefs that the other party was not very interested in cooperation. This made moving away from conflict difficult, even though the parties were fully aware that they had a lot to gain by doing so. To see this more clearly, some basic concepts from game theory can be helpful (Schelling 1960; Binmore 1994).

LO and NAF evidently faced a situation in which the consequences of each party's action depended on the action taken by the other. The strategic interaction they faced can be illustrated with the well-known assurance game, with the available actions and payoffs illustrated in Figure 2, where $a > b > c > d$.

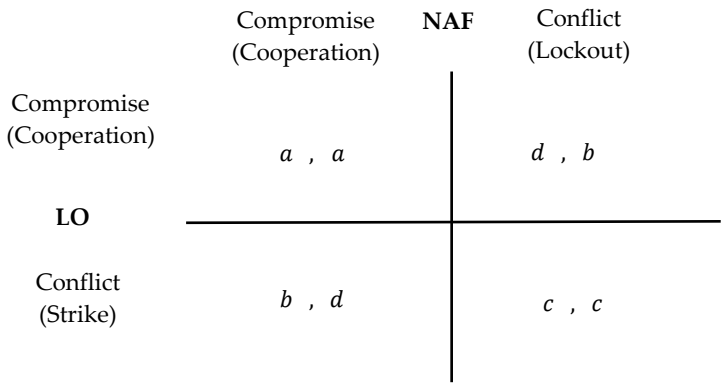



**Figure 2.** The assurance game.

If both players decide on a compromise, an agreement will be struck without inflicting the cost of a conflict. This secures both players the highest possible payoff ($a$). If one player deviates from compromise—that is, if LO implements a strike or NAF effects a lockout, a costly conflict takes place. If one player choses conflict and the other choses compromise, the former "wins" and receives $b$, while the latter "loses" and receives $d$. If both players choose conflict, they both receive the payoff $c$. Hence, the assurance game formalizes a situation in which the sensible thing to do depends on the players' beliefs about the likely behaviour of the other player. If player 1 thinks that player 2 will choose conflict as their main strategy, player 1 will also choose conflict (since $c > d$), but if player 1 thinks that player 2 will choose compromise, player 1 will want to choose compromise as well (since $a > b$). The same reasoning holds for player 2, meaning that the strategic interaction has two Nash equilibria: mutual conflict and mutual compromise (e.g., see Binmore 1994; Chong 1991; Sen 1967; Skyrms 2004; and Taylor 1987 for a more detailed exposition).

The strategic interaction captured by the assurance game highlights the role of trust in hindering or fostering cooperation, since trust is intimately related to beliefs (Hardin 2006; James 2002; Rousseau et al. 1998; Van Lange et al. 2017). As Gambetta (1988) notes, "When we say we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of cooperation with him" (p. 217). According to Gambetta (1988), trust is a belief about the likely behaviour of an interacting partner. By combining this conception of trust with the strategic interaction specified above, we can say that the level of trust one player has for another is the perceived likelihood that the other player will cooperate (compromise). Both players are willing to cooperate only if they perceive the probability that the other party will also cooperate as being high enough. If the players believe that the other party will play conflict, both will play conflict.

Based on this reasoning, explaining why LO and NAF, in a situation with constantly open conflicts, acted in a way that reproduced that same situation is not difficult. Both parties carried historically created beliefs that the opposite party had no intention of compromising. This led both parties to choose conflict as their main strategy, and the outcome was conflict, which in turn confirmed the parties' initial beliefs. Nevertheless, the parties managed to escape this unfortunate sub-optimal Nash equilibrium and move into the other Nash equilibrium characterised by mutual compromise. What happened?

Below, I argue that, under the surface of conflict, several critical economic and political events gradually changed the spiral of mistrust. LO and NAF slowly, but surely, realized that compromises and cooperation looked more attractive for *both* organizations, and in the end, they both obtained the necessary assurance that, if they settled for a broad compromise, the other party would do the same. The parties' beliefs reached a critical threshold that induced both LO and NAF to step away from conflict as their main strategy. The signing in 1935 of the Basic Agreement clearly expressed this.

Figure 3 shows the critical events that contributed to changing the parties' beliefs and that ultimately helped to establish the necessary trust needed for the actors to switch from conflict to compromise as their main strategy.

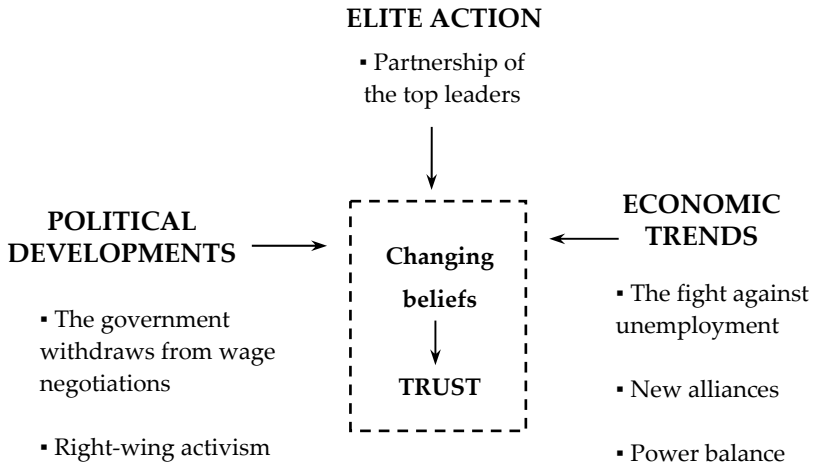



**Figure 3.** Factors that contributed to the establishment of trust between LO and NAF.

The first event (partnership of the top leaders) was related to elite action and initiatives taken by the top leadership in the two organizations. The next three events (the fight against unemployment, new alliances, and the power balance) can be grouped as follows: one under economic trends, and last two events (right-wing activism and the government's withdrawal from wage negotiations) under political developments. In the following, I discuss in more detail how these events contributed to changing the parties' beliefs.

## 3. Critical Events and Changing Beliefs

### *3.1. Elite Action*

Despite all the labour conflicts between the world wars, both LO and NAF were clearly willing to cooperate and compromise, but this was primarily expressed though informal contacts and meetings between the top leaders of the organizations (Bull 1984; Knutsen 1985; Olstad 2019). It has been documented that these informal meetings affected the outcome of several conflicts in the 1920s, but the indirect effects of these meetings were probably more important. They contributed to gradually establishing trust between the top leaders of LO and NAF (Knutsen 1985).

An early example of contact between the leaders of LO and NAF is related to the struggle against the syndicalist and communist opposition groups within the union movement. With an increasingly radicalized labour movement, the leadership of NAF took the initiative to cooperate with the leadership of LO in the early 1920s to support and strengthen the position of its more moderate leaders. However, the leadership of NAF did not receive support for such a collaborative strategy within its own organization. The employers in general thought there was no reason to show leniency towards LO. They were convinced that the government would intervene resolutely in any illegal actions by the unions. Nevertheless, the event illustrates a change in attitude among the leaders of the two organizations. A new form of trust was established.

A somewhat later example of the willingness to compromise throughout the conflicts is the contact that LO and NAF had before the wage settlement in 1925. These negotiations at the highest levels between the organizations took place in the utmost secrecy (Knutsen 1985). Similar negotiations also contributed to ending the extensive and illegal construction workers' strike of 1928 (Bjørgum 1985). However, in that case, LO and NAF did not aim to keep secret the fact that the leaderships had reached a compromise. For the first time, the parties openly expressed a desire to cooperate and admitted that this could benefit both parties. LO president officially referred to the occasion as "... a victory

for both organizations" (Knutsen 1985, p. 407). An understanding of the benefits of dialogue, negotiations, and compromises had been developed and also publicly stated. The leadership of the two organizations was more aware that they both strived for a more peaceful relationship.

### *3.2. Economic Trends*

#### 3.2.1. The Fight Against Unemployment

The fight against the record-high unemployment that characterised Norway and most other countries in the 1930s also played an important role in moving LO away from conflict as their main strategy. The unemployment rate among union members was 33% in Norway in 1933. With unemployment at this level, the leadership of LO understood that it had a responsibility to contribute to reducing unemployment and that constant labour conflicts represented an obstacle to this. LO signalled a clearer willingness to moderate their wage demands and to take greater responsibility for the unemployed (Olstad 2009). The main goal of LO was no longer to maximize wages for those already employed.

At about the same time, the Labour Party launched a crisis plan in an attempt to address the high unemployment rate. This marked an initial cautious alternative to the dominant economic thinking at the time. To increase production and employment, the government was assigned a more active role in the effort to stimulate demand. The crisis plan was inspired by Keynesian economic ideas, which were also introduced around this time. Nevertheless, formulating an effective recovery policy was difficult as long as the parties of the labour market were unwilling to cooperate. In particular, the challenge was that increased government spending would increase the bargaining power of those who were already employed, especially those employed in firms sheltered from international competition. If increased demand resulted in raising the wages of the insiders in the labour market, this would not only limit growth in employment, but would also affect companies competing internationally. In order for the Keynesian policies to work as intended, local militant unions had to be brought under control.

The employers were the first to seek a solution (Bjørgum 1985; Bowman 2002). To take wages "out of the hands" of local unions, NAF worked hard to centralize the wage-bargaining process. They clearly signalled to the leadership of LO that their approach was not to fight against the unions to hold wages down. Rather, their strategy was to give more power to the leaders of the labour movement as a whole (the leadership of LO) and, thus, strengthen unions as institutions (Bowman 2002; Moene and Wallerstein 2006). The employers thus signalled a clearer willingness to cooperate with LO. This idea was, of course, appreciated by the leadership of LO. Thus, both organizations seemed to gradually realize that the recovery policy would not work without industrial peace and cooperation around more coordinated and centralized wage setting.

#### 3.2.2. New Alliances

Within the labour movement, the labour unions representing workers in the export sectors especially supported the employers' idea of a more centralized and coordinated system of wage setting. These unions feared that militant unions within the sheltered sectors of the economy, such as the unions organizing construction workers, would drive up wages if increased government spending boosted the aggregate demand. High home-market wages would create great difficulty for union leaders in the export sectors to maintain the wage moderation required for international competitiveness. As a result, an implicit coalition between the employers and the unions in the export sectors arose. Both parties considered centralized wage coordination essential for controlling wage growth in companies sheltered from international competition. Again, it seemed increasingly apparent to the leaderships of LO and NAF that they had shared interests in a closer cooperative relationship.

#### 3.2.3. Power Balance

In 1931, the most wide-ranging labour conflict in Norway so far took place. Norwegian historians broadly think that this conflict ended in a draw—but with great financial losses on both sides (Olstad 2009). NAF had built up significant debt, and LO's strike funds were nearly gone. A power balance appeared to have been established. The organized labour movement had seriously demonstrated to the employers that it had come to stay. LO understood from its perspective that safeguarding the members' income and jobs required finding solutions that did not threaten companies' existence. Both parties seemed to realize that labour and capital were bound to one another, whether they liked it or not. Hence, the massive conflict of 1931 was an important contribution to the promotion of an understanding among both organizations that the other side could not be defeated through conflict. They had to seek a new strategy. Cooperation over a reasonable distribution of results looked more and more desirable for both parties.

### *3.3. Political Developments*

#### 3.3.1. Right-Wing Activism

The international political climate throughout the 1930s was increasingly characterised by a rightward shift in state and society. Fascism's growth in particular represented a serious threat to the organized labour movement. In such countries as Italy, Spain, Germany, and Austria, deliberate policies were carried out to destroy and split up the unions. The press continually reported incidents throughout Europe in which union leaders were imprisoned, mistreated, and killed.

In Norway, the Farmers' Party (the predecessor to the modern Centre Party) led the government in 1931. This marked a transition to a policy that was openly hostile towards unions. Together with the Conservative Party (Høyre), the Farmers' Party wanted to protect capital and the employers by forbidding strikes in "key enterprises" and to regulate working life by law (Falkum 2015). This shift in politics, combined with clearer right-wing activism in the rest of Norwegian society and abroad, made it increasingly important for the leadership of LO to avoid major conflicts with the employers and the government—which could have led to the labour movement being left essentially on its own. The leadership of LO understood that the cost of continued conflict could be very high. Cooperation with employers over pragmatic solutions was considered important to avoid ending up in the same desperate situation as the union movements in many other countries (Olstad 2014, 2019). The leadership of LO managed to get this message through to both the employers and to the more radical and hard-line local unions and their members.

#### 3.3.2. The Government Withdraws from Wage Negotiations

At the same time, the employers became much more interested in forming an alliance with LO. In 1933, the so-called labour-hostile laws proposed by the Farmers' Party were voted down by the Stortinget (Parliament). This brought the Liberal Party (Venstre) back into power. They moderated the proposed legislation and very clearly signalled that they intended to withdraw from the wage-bargaining process and leave the wage settlement to the parties of the labour market. The new government seemed to realize that they were more or less powerless in many of the labour conflicts and that politically regulating working life by law did not lead to the intended results (Falkum 2015). They also stated openly that they wanted to remain neutral between employers and unions. This broke the old alliance between the government and the employers, which represented a new strategic situation for the employers' confederation.

NAF could not no longer rely on any guarantees from a powerful third party that could enforce a specific resolution—most likely favouring the employers. NAF increasingly realized that seeking compromises with LO was vital to avoid costly and lengthy conflicts. Behind this adjustment of strategy, however, was a clear change in ideology (Bowman 2002; Falkum 2015). NAF wanted to keep as much influence as possible in the formal rules that regulated and limited their activities. Instead of just accepting the laws decided by "weak"

political institutions, the employers wanted to strengthen their own political power and set the political agenda regarding the rules of working life. But they were not strong enough to manage this on their own. They had to seek out compromises with LO and to accept LO as a partner in the struggle to gain as much control as possible over the fundamental rules of working life.

## 4. Beliefs, Trust, and Cooperation

Together, the events discussed above led to a mental reorientation of the two main parties of the labour market in Norway. This reorientation was necessary to move the parties out of their difficult spiral of conflict and mistrust. LO and NAF had been in conflict for a long period, and therefore, they each strongly believed that the other side was not very interested in compromising. Given this belief, the parties had no reason to change their strategy from conflict to a more cooperative approach, as the assurance game in Figure 2 also illustrates. Since both parties risked losing if they backed off while their opponent continued to stand firm, they needed to be assured that the opponent would be willing to compromise and cooperate for them to do the same.

As outlined in Section 2, it follows from the assurance game that player 1 is willing to compromise only if he trusts that player 2 will do the same, where player 1's trust is anchored in the belief he has about the likelihood that player 2 will compromise. The same reasoning applies for player 2. Figure 4 illustrates this coordination problem.

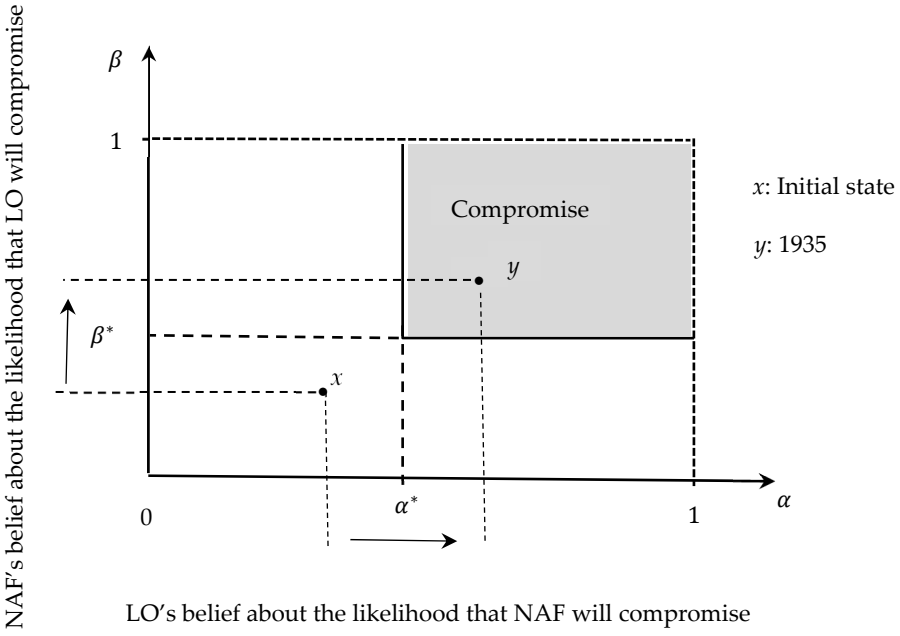



**Figure 4.** Equilibria in the assurance game.

The horizontal axis measures LO's belief about the likelihood that NAF will compromise, denoted as $\alpha$. The vertical axis measures NAF's belief about the likelihood that LO will compromise, denoted as $\beta$. If both players have a strong enough belief that the other player will cooperate, then both will cooperate. This situation is fulfilled in the shaded upper right corner of Figure 4. Outside this area, one or both players are too mistrustful to cooperate. This was basically the situation that LO and NAF faced between the world wars. They were in conflict and had been in conflict for many years. Both LO and NAF lacked the necessary trust to choose compromise as their main strategy. They were stuck in something that looked like point $x$ in Figure 4.

Several events between the world wars gradually changed the parties' beliefs. LO and NAF realized that compromises and cooperation looked more attractive for both parties compared with continued conflict. They formed beliefs telling them that, if they settled for

a compromise, the other party would do the same. The level of trust gradually increased until it reached a point where it was high enough for them to take the risk of switching from conflict to compromise as their main strategy. The parties' beliefs were pushed over the trust thresholds $\alpha^*$ and $\beta^*$ in Figure 4, where compromise became the rational strategy for both organizations to adopt. LO and NAF settled into something like point $y$ in Figure 4, and a new equilibrium in the game between the two main parties of the labour market was established. The Basic Agreement was signed in 1935, as a clear manifestation that labour and capital were ready to manage their conflicts of interest very differently than before.

The analysis presented above shares some clear similarities with Basu's (2018) influential work in law and economics. A key question within law and economics is why some laws are effective while others are not, but Basu (2018) takes this question a step further. Since laws are basically just words on paper, why should they affect people's behaviour at all? Or, as Basu (2018) notes, "If everybody behaved the way they did before the law, then everybody would get the same payoff after the law, since mere writing down of the law cannot change the payoffs" (p. 35). A new law does not change the game people are playing, meaning that the new law by itself does not have any effect on behaviour. Still, we know that laws change the way people behave (at the same time as we know that there are many laws that are ineffective). The way that the law can change people's behaviour, according to Basu (2018), is by changing people's beliefs about what other people may do. If actor A expects that that a new law will change other people's behaviour, what represents A's optimal behaviour might change. This also holds for other people. If other people expect other people's behaviours, including those of actor A, to change, what represents other people's optimal behaviour might also change. Basu (2018) concludes that "If behavior is to change, there must be an internally consistent structure of beliefs each of which is propped up by the others, which makes society shift to a different pattern of behavior. In this sense we are all citizens of the republic of beliefs" (p. 40).

The historical event analysed in the present article (the making of the Basic Agreement in Norway) is explained by changes in beliefs among the dominant actors that made the Basic Agreement possible. The actors (LO and NAF) gradually changed their beliefs about the most likely behaviour of their interacting partner, but, equally important, actors also changed their beliefs about the other actors' beliefs. LO believed that NAF believed that LO would opt for a compromise, and vice versa. These changes in beliefs were not, however, a result of a new law. They were brought about as the result of a series of social, political, and economic events, but the result was the same. Changes in beliefs induced LO and NAF to shift to a markedly different pattern of behaviour.

It is worth emphasizing that, in parallel with a gradual change in beliefs, the payoffs of the game between LO and NAF also changed in the period up to 1935. Rapid technological changes in the early twentieth century led to increasing productivity, in turn increasing the gains from cooperation and compromises. This clearly helped the parties move away from conflict and coordinate on a new cooperating equilibrium. Increasing the payoff from mutual compromise relative to mutual conflict lowers the critical trust thresholds, $\alpha^*$ and $\beta^*$, making compromise easier. This can be illustrated as an expansion of the cooperative area in Figure 4 and echoes a standard result in the trust literature (Kydd 2005). The greater the potential gains from cooperation, all else being equal, the less trusting the parties must be to cooperate. Alternatively put, the greater the value of cooperation, the greater the risks the players will be willing to take in an effort to achieve it.

Changes in material conditions clearly played a role in the development of the relationship between labour and capital, both in Norway and in other countries in the early nineteenth century and beyond. However, the establishment of an extensive collaborative arrangement such as the one that the Basic Agreement represents would not have been possible in Norway without a significant change in historically created mental maps and beliefs among the main parties of the labour market.

## 5. Concluding Remarks

Moving a relationship of distrust and conflict into a virtuous circle of trust and cooperation is challenging. The general pattern is rather that conflict and distrust breed more conflict and further distrust. This was basically the situation in Norway's labour market in the early twentieth century. Norway had the highest levels of labour conflict in Europe between the world wars, and the labour market parties mistrusted each other deeply. This situation changed markedly when the Norwegian Confederation of Trade Unions (LO) and the Norwegian Employers' Confederation (NAF) signed the Basic Agreement in 1935. The signing of the Basic Agreement marks a turning point in the history of labour relations in Norway. The agreement produced a lasting decline in the level of strikes and lockouts and embodied a completely new way of managing industrial conflicts.

What enabled the transition from open class conflict and mistrust to cooperation and compromise? As discussed in this article, the main problem that the labour market parties faced was that they had been in conflict for a long time, they mistrusted each other, and they believed that the other side was not very interested in compromising. Given these beliefs, both parties had to convince each other that they wanted to reduce the level of conflict and to adopt a more cooperative approach. Several events between the world wars brought the parties closer together, which in turn led to the necessary changes in the parties' beliefs. Both LO and NAF received the necessary assurance that, if they compromised, the other party would do the same. They were ready to sign the Basic Agreement.

The agreement that was struck between the labour market parties in 1935 was crucial for the developing Norwegian society after the Second World War. When the Basic Agreement was in place, it led to the further development of trust and cooperation between labour and capital. Many key features of Norway's working life model, including its high productivity, extensive worker involvement in decision-making processes, low unemployment, small wage differentials, and high social protection, resulted from this collaboration (Moene 2013). Hence, understanding the development of Norway's working life model is difficult without properly understanding the changes in Norwegian society before the Second World War.

The analysis provided in this article may also serve as a reminder of the fact that trust and a consensual model of decision making is a product of the Nordic model—not a prerequisite. Sweden's situation was roughly similar to the developments in Norway between the world wars. Sweden obtained its Basic Agreement (Saltsjöbadavtalet) in 1938, and this also emerged out of difficult circumstances. In fact, Sweden was second only to Norway in the level of labour disputes between the world wars. As Moene and Wallerstein (2006) noted, international observers often express the view that the Nordic experiences are not very relevant to other countries. They seem to believe that the Nordic model "(. . .) is only possible in consensual, homogeneous, and affluent societies with an extraordinary commitment to equality" (p. 148). But this is clearly a misunderstanding, given that: ". . . conditions in Norway and Sweden in the period preceding the social democratic ascent to power were anything but consensual, egalitarian, and affluent" (p. 150). From this perspective, lessons may be learned from the Nordic experiences, even for countries that are quite different from present-day Nordic societies.

Finally, the case discussed in this article also contributes to the literature on the evolution of trust and cooperation. Trust is important for society to function well. When trust is there, initiating cooperative relationships and securing joint gains is easier for potential partners. However, research investigating how a situation of distrust and conflict may move into a situation of trust and cooperation is sparse and limited (Rothstein 2000). We know that the initial conditions characterising interpersonal and interorganizational relationships strongly affect the development of these relationships at later stages. Low levels of trust in the early stages often trigger dysfunctional spirals of distrust that can be very difficult to stop. Moving a relationship of distrust into a virtuous circle of trust can be even more demanding. The case examined here shows, however, that initial distrust

and conflict do not always lead to further distrust. A problematic start can lead to a happy ending.

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