

Is the Western Welfare State Still Sustainable?

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“Half a century ago, the free-market economist Friedrich von Hayek argued that a large public sector would threaten democracy itself, putting European countries on a ‘road to serfdom’. Yet the Nordic states have thrived, not suffered, from a large social welfare state, with much less public-sector corruption and far higher levels of voter participation than in the US. . . . Von Hayek was wrong. In strong and vibrant democracies, a generous social-welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness.”

—Jeffrey Sachs

Scientific American, November 6, 2006, p. 42

Figure 1: Open Unemployment Rates in the OECD

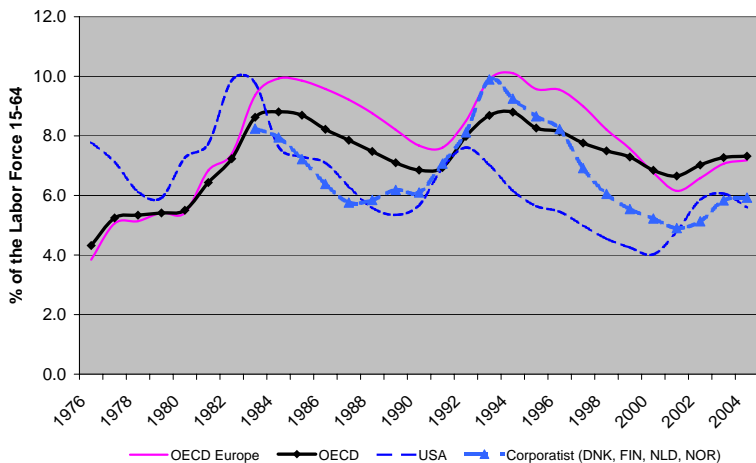


Figure 2: Labor productivity growth in the business sector

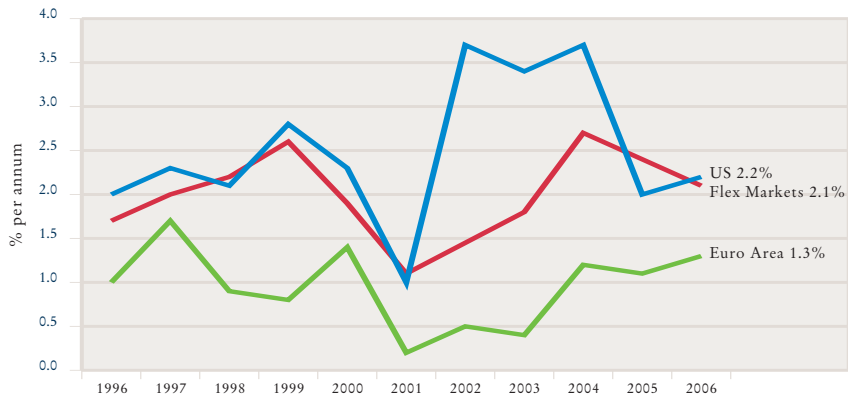


Figure 3: Real GDP Growth

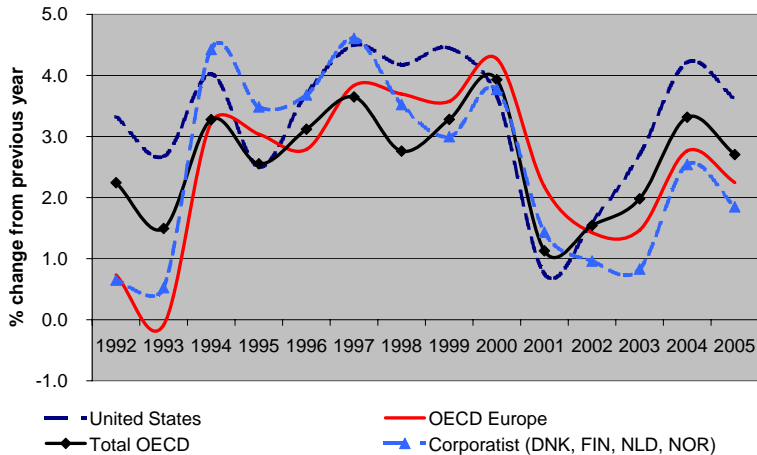
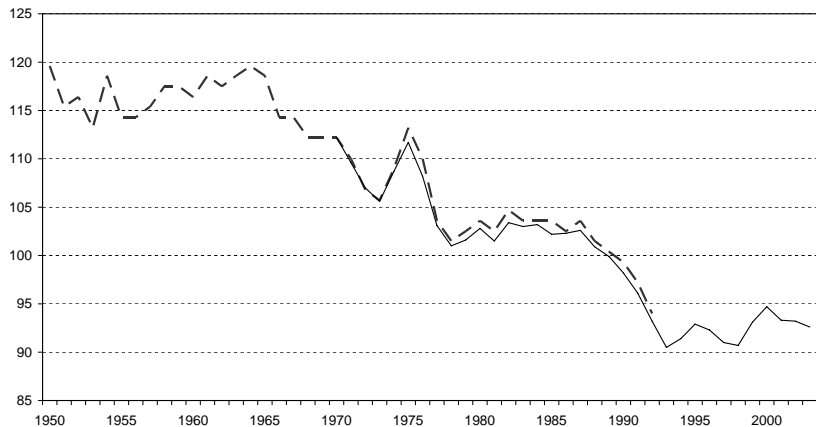
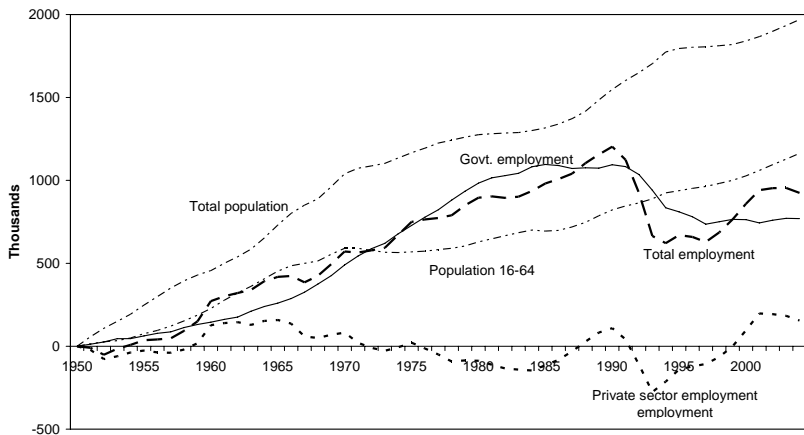


Figure 4: PPP-Adjusted GDP per Capita in Sweden as Percent of OECD Average, Penn World Tables (1950–92) and OECD statistics (1970–2003), OECD-23 = 100



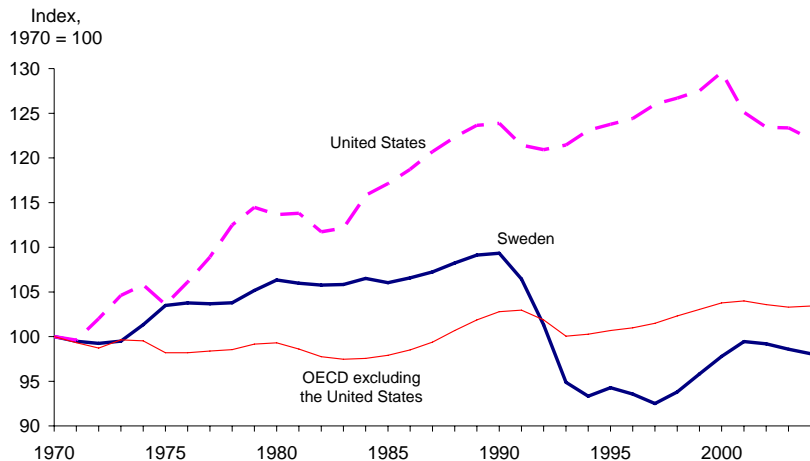
Source : Davis and Henrekson (2006)

Figure 5: Cumulative Employment and Population Change in Sweden, 1950–2004



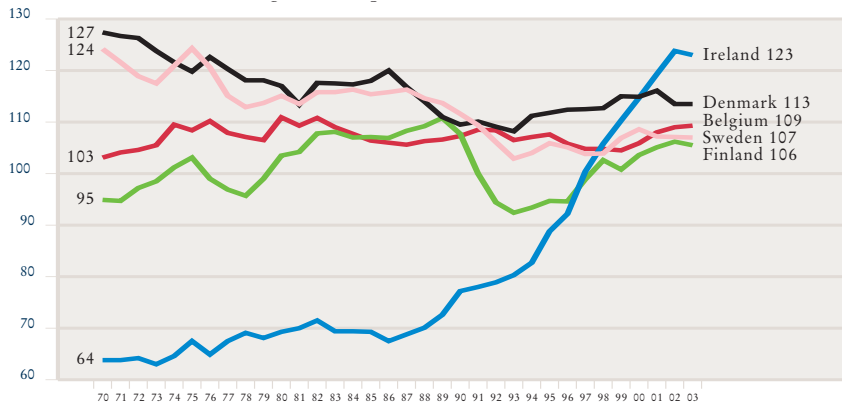
Source : Davis and Henrekson (2006)

Figure 6: Population-Adjusted Employment Growth, 1970–2004



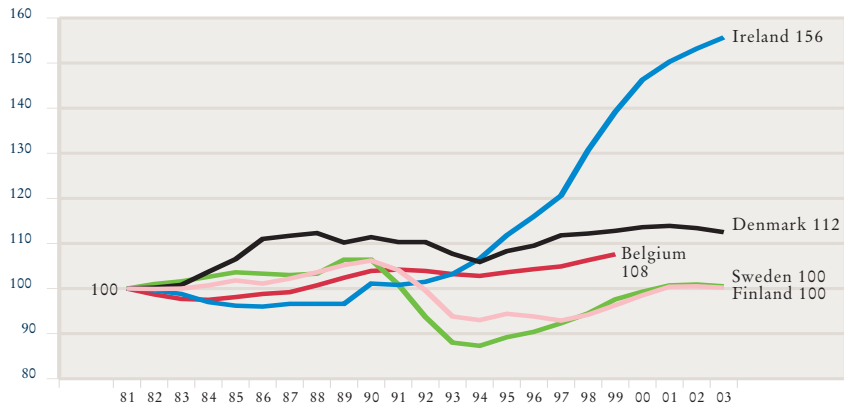
Source : Davis and Henrekson (2006)

Figure 7: Prosperity levels 1970-2003 (OECD=100) - GDP/CAP using current prices and current Purchase Price Parities



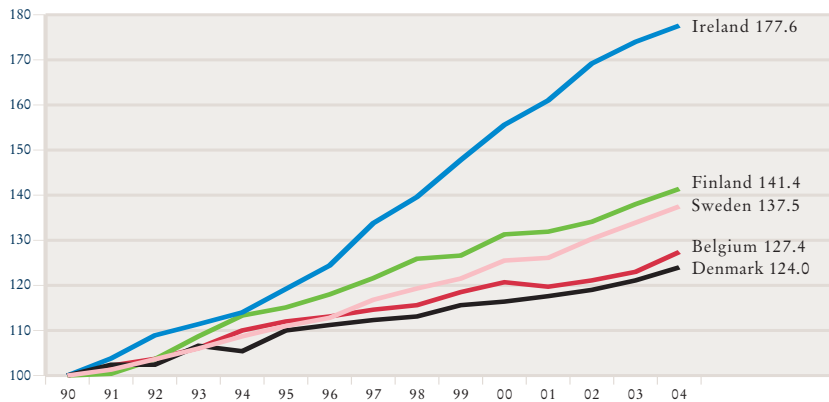
Source: OECD

Figure 8: Job creation - Total civil employment (1981=100)



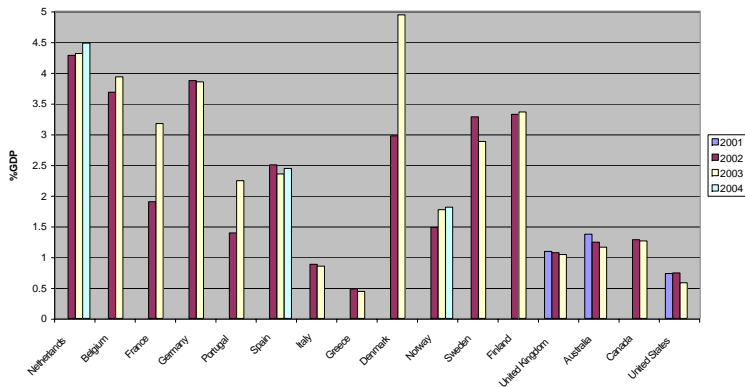
Source: OECD

Figure 9: Productivity per working hour (1990=100)



Source: OECD

Figure 10: Total expenditure on training and passive/active labor market programs (%GDP)



Source: OECD Labor Force Statistics, 2005

Figure 11: Open and Full Unemployment

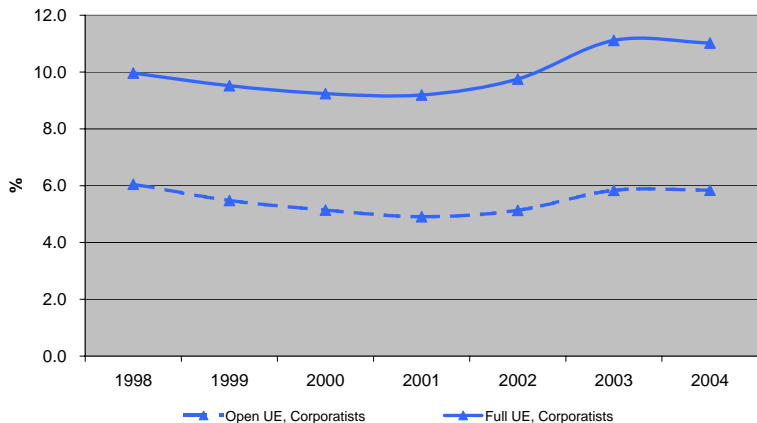


Figure 12: Differences between Open and Full Unemployment, 1998-2004 averages

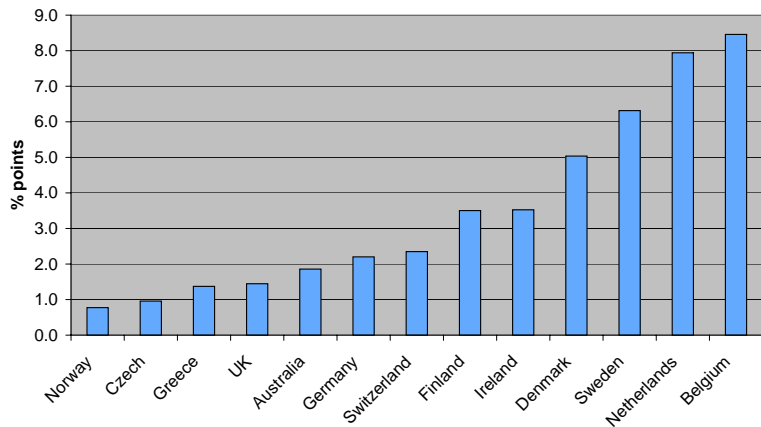
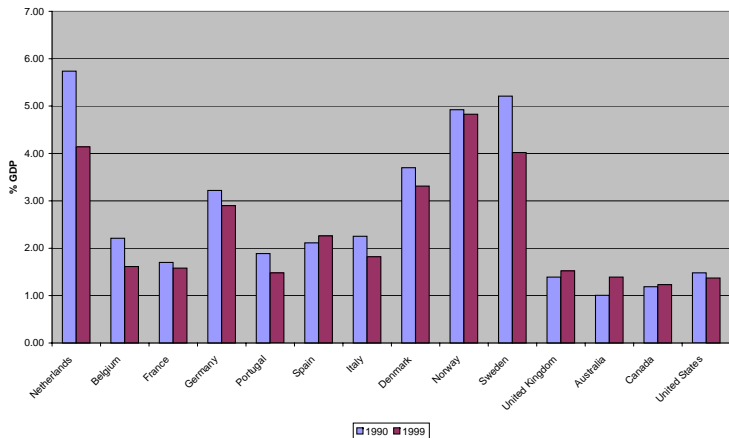
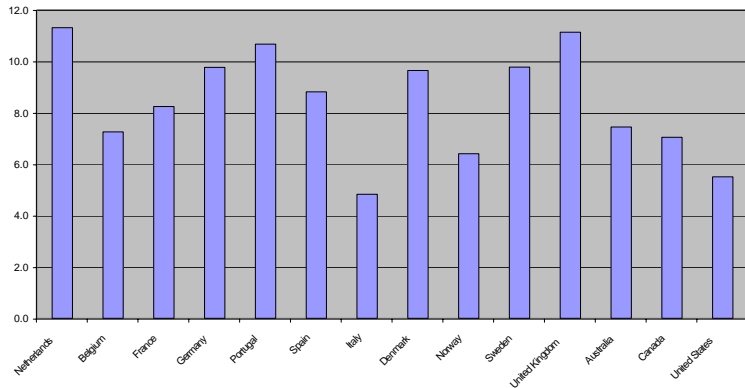


Figure 13: Disability related expenditures (%GDP) in 1900,1999



Source: OECD Social Indicators 2005

Figure 14: Non-employed disabled workers (% of labor force)



Source: OECD Social Indicators, 2005

Figure 15: Open and Adjusted Employment Rates in a Subset of European Countries

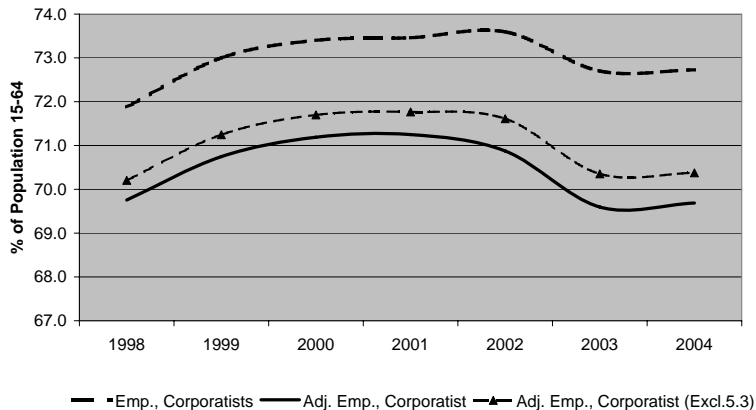


Figure 16: Differences between Open and Full Employment rates, 1998-2004 averages

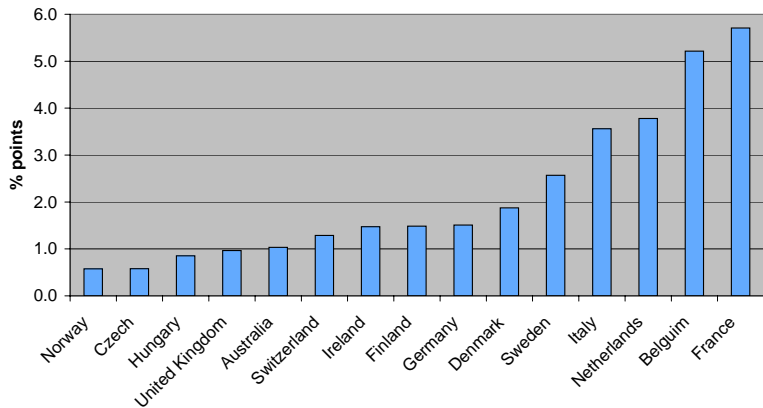


Figure 17: Public Sector Employment Share

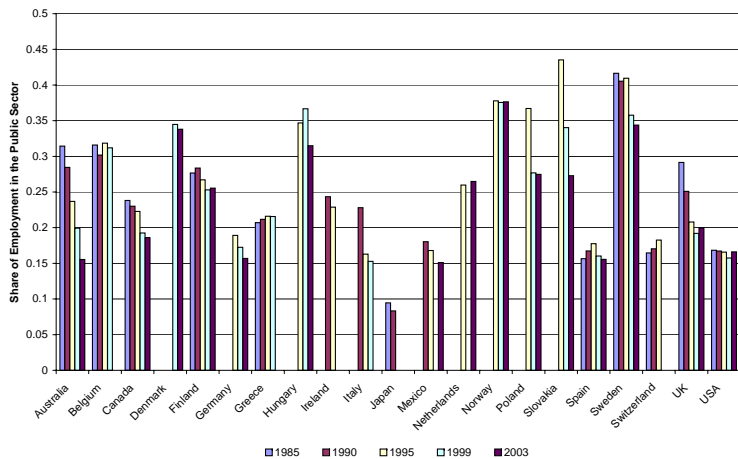
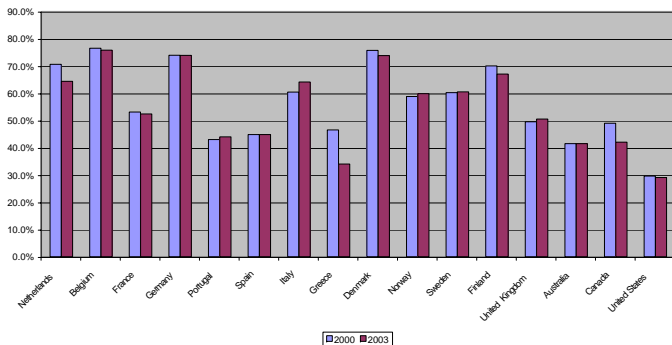


Figure 18: Total marginal tax wedge on personal income, including consumption taxes (% of income) for a single worker earning the average production wage without children (US: no cons. taxes available)



Source: OECD Tax Database, 2005

Figure 19: United States: single person

METR: Marginal Effective Tax Rate

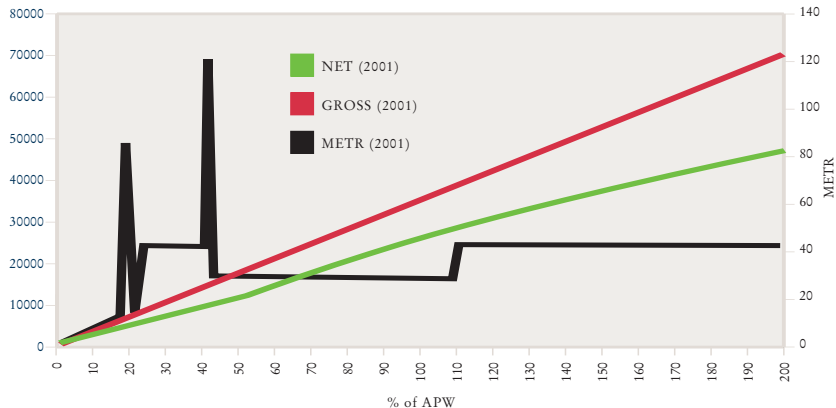


Figure 20: Sweden: single person

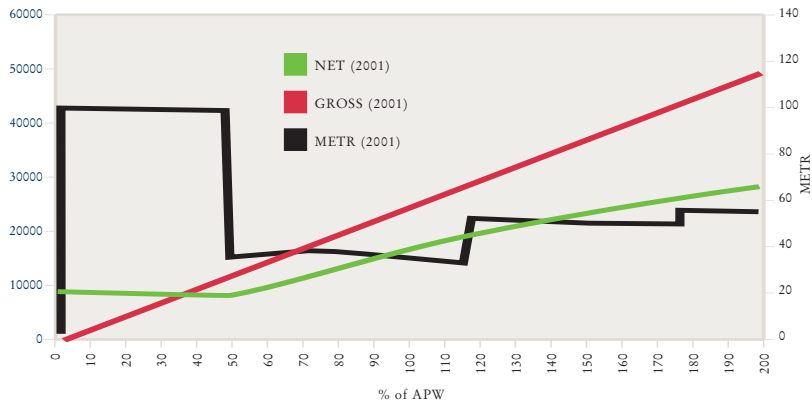
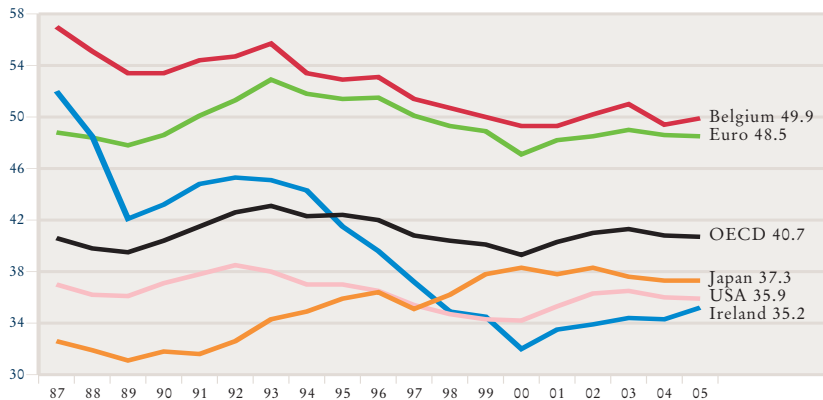
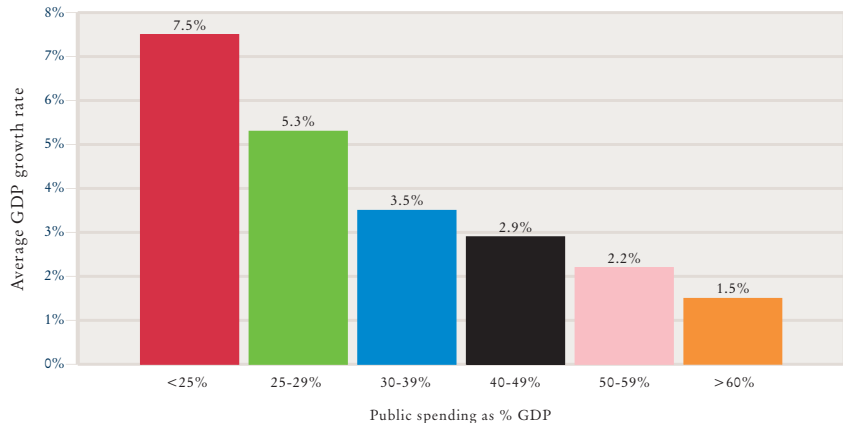


Figure 21: Public spending as a % of GDP



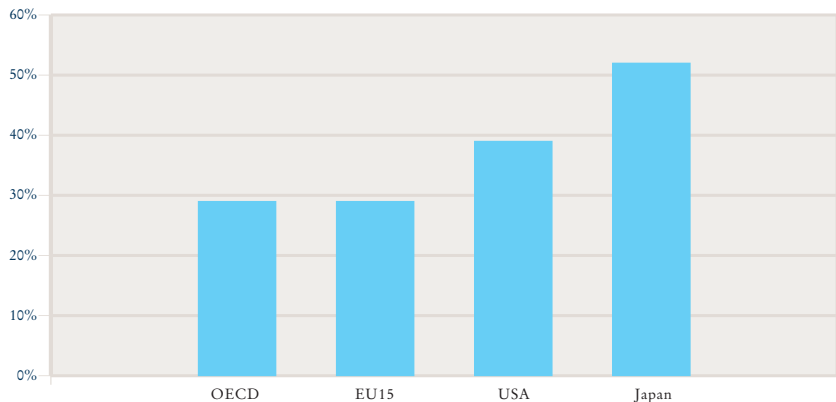
Source: OECD

Figure 22: Correlation of growth and public spending - 30 OECD countries, 1960-2005



Source: OECD Economic Outlook, Mullally (2006)

Figure 23: Proportion of 25-34 age group with university education



Source : OECD Education at a Glance, 2005

Source: OECD Education at a Glance, 2005

Figure 24: Real expenditure per student in US \$

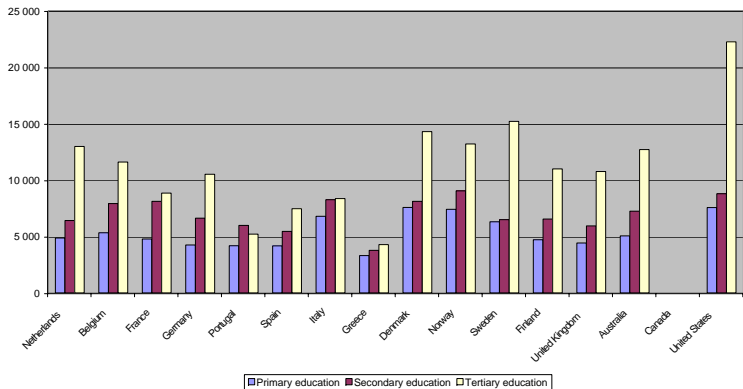
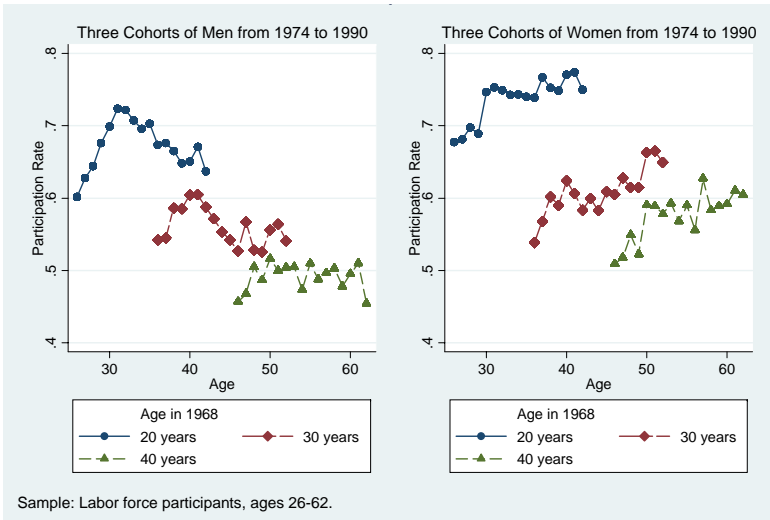


Figure 25: Sick Leave Participation for Men and Women



Summary

- Elevate the discussion of the welfare state beyond the level of endorsing one system over another.
- Go to the essential features that underlie the success of aspects of many systems.
- It's all about **incentives** to produce, create, succeed.

Summary

- Incentives to work rather than to politic.
- Incentives to seek jobs (sanctions in Holland and Denmark).
- Incentives to invest as opportunities arise, to venture, to build for the future.
- Incentives to move (as in the flexicurity system), not lifetime jobs.

Summary

- The long-run trends in modern Western welfare states are not favorable even in the Nordic countries.
- High levels of welfare state taxation, protection and generosity erode the dynamism of a society.
 - (a) Builds a culture of dependency that erodes innovation.
 - (b) Creates a level of complacency and erodes the work ethic and incentives to invest in skills and in the larger society.
 - (c) Creates a system that protects the status quo and is very difficult to change except when a crisis appears.
 - (d) Witness Ireland, Finland, Holland, Sweden where changes occurred only in moments of crisis.

Summary

- Many European welfare states are not creating incentives for investment in skills needed for performance in the global economy.
- The policies in place reduce incentives to work and create dependency.
- Need to think creatively about incentives :
 - ① Create incentives for mobility, but at the same time give workers some security (Denmark “flexicurity”).
 - ② Create incentives to work (WTC, EITC, UK / US) — not participate in welfare. Boost productivity and raises levels of well-being and social integration.
 - ③ Use social insurance accounts that insure, but retain flexibility.

Summary

- The political economy of present arrangements in Western Europe is rigged against reform because so many persons are beneficiaries of the current system.
- Reforms that have occurred are small.
- More drastic reforms are needed.
- Most of the reforms that have been put in place have come in the wake of an economic crisis.
- There is little internal capacity for democratic societies to reform themselves without a crisis.

Summary

- In principle, society can undo one distortion with another. However,
 - ① Devising such incentives is complicated.
 - ② The social system is delicate and, as von Hayek often stressed, the essential details are not really known well enough to plan successfully with any precision.
 - ③ Easy to create perverse incentives, and there are many examples.

Summary

- Current measurement systems used to evaluate policies and compare economic performance are flawed and conceal problems that are readily exposed once we disaggregate and look at what is going on at the individual level.
- Creating the will to make the necessary reforms within a democratic welfare state is a very difficult process.

Summary

- Successful reforms in the welfare state have all come in the wake of a crisis.
- The politics of the welfare state often lead to reversal of the reforms after the crisis passes.
- Based on the historical record, crisis is inevitable before meaningful reforms are implemented.

Summary

- On a more optimistic note, if the basic economic forces are analyzed in an intellectually honest way and the public is educated on the need to respect and implement incentives, we can elevate the level of the dialogue on the welfare state.
- Then, the reforms needed to make the welfare state viable might be achieved without the wrenching crises that have spawned most reforms in the past two decades.