

Perspectives on the Performance of the Continental Economies

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Revisiting the Nordic Model: Evidence on Recent Macroeconomic Performance

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[–] Abstract and Keywords

This chapter examines the economic and political performance of three groups of high-income countries—Nordic, European continental, and English-speaking countries—with vastly different systems of social protection. It shows that highly ideological claims made against the social welfare states of Scandinavia are simply off the mark. The “euro-pessimism” in many parts of continental Europe, and the claim that Anglo-Saxon liberalization is crucial to economic well-being, is belied by the persistent high performance of the Nordic economies.

Keywords: economic performance, political performance, high-income countries, Nordic countries, social welfare system, welfare state

12.1 Introduction

For twenty-five years the US political system has been in the midst of a heated debate over taxes and growth. US supply-siders have argued that high rates of taxation cripple economic growth and lower living standards, and that tax cuts are indeed sufficiently stimulating to economic activity as to be self-financing. From the supply-sider point of view, low tax rates in the United States explain US dynamism, while high European tax rates explain European stagnation. More generally, Europe’s tax-financed social welfare state is seen as undermining incentives both due to high tax rates and the high levels of social spending that they finance.

Europeans too are in a long-standing debate about the social welfare system. With chronically high unemployment in several European countries, many “Euro-pessimists” are calling for significant cuts in taxation and social expenditures, often with the same argumentation as the US supply-siders. The claim is that the social welfare state is no longer affordable, especially in a globally interconnected economy.

As often happens, these debates have shed much more heat than light, since the use of evidence has been wildly selective. This is ironic, since the cross-country evidence actually gives us a generation of macroeconomic experience operating under very different forms of capitalism. The range of social spending and taxation relative to national income across the OECD countries is

very large and relatively stable. To the extent that high taxation and social expenditures cripple economic activity, we should have plenty of evidence over a considerable number of years to show that that this has been the case.

Considered in this chapter are three groups of high-income countries. The first group is the Nordic (N) economies of Denmark, Finland,

(p.388) Norway, and Sweden. All of these countries maintain very high levels of social expenditure as a share of GDP. The second group of countries includes the core European continental (EC) countries of the European Union: Austria, Belgium, France, Germany, Italy, and the Netherlands.¹ The third group of countries includes the English-speaking (ES) countries: Australia, Canada, Ireland, New Zealand, United Kingdom, and United States, all of which have a lower share of social spending in GDP than the European continental states and the Nordic states. Excluded from the analysis are the very small countries of the OECD (Iceland and Luxembourg), the poorer southern European states (Greece, Portugal, and Spain), Switzerland (as a non-EU country distinct from other continental economies), and the developing-country members of the OECD.

The evidence reviewed in this chapter, on the economic and political performance of these countries in view of their vastly different systems of social protection, is with regard to the question: Is there evidence that the high rates of taxation have caused low rates of economic growth, low levels of income per person, major disincentives to work, and perhaps even a diminution of freedom (in line with the Von Hayek-Friedman argument that state intervention leads to a loss of freedom)? The short answer is no. Despite the vigor of supply-sider arguments in the United States and the corresponding euro-pessimist arguments in Europe, the Nordic countries have not suffered obvious liabilities regarding economic growth, standards of living, labor force participation, or political freedoms. If anything, the data suggest in fact the opposite.

Before proceeding, it is important to make two further points. First, like the Anglo-Saxon economies, the Nordic economies are overwhelmingly private-sector owned, open to trade, and oriented to international markets. Financial, labor, and product market forces operate powerfully throughout non-state sector. In short, these are capitalist economies. Moreover they are far from rigid. Industrial change is accepted, even encouraged pro-actively. For example, change in the productive economy (both the creation of new sectors and the “creative destruction” of declining industries) is encouraged through active labor market policies, public-sector commitments to higher education, retraining, and R&D, and other institutions.

Second, there is no single Nordic model, and still less, an unchanging Nordic model. What has been consistently true for decades is a high level of public social outlays as a share of national income, and a **(p.389)** sustained commitment to social insurance and redistributive social support for the poor, disabled, and otherwise vulnerable parts of the population. The details of those policies—including labor market regulations, incentive structures, and coverage rates—have evolved over time, sometimes in the face of financial difficulties, high unemployment, or institutional failures. Nordic governance, in other words, has generally been active and alert to the need for change.

12.2 Levels of Social Outlays

Since the supply-side critique focuses on the alleged high costs of taxation for economic well-being, I start with a comparison of the total tax take across these groups of countries. As can be seen in figure 12.1a, the ratio of total government receipts (taxes plus other receipts) to GDP

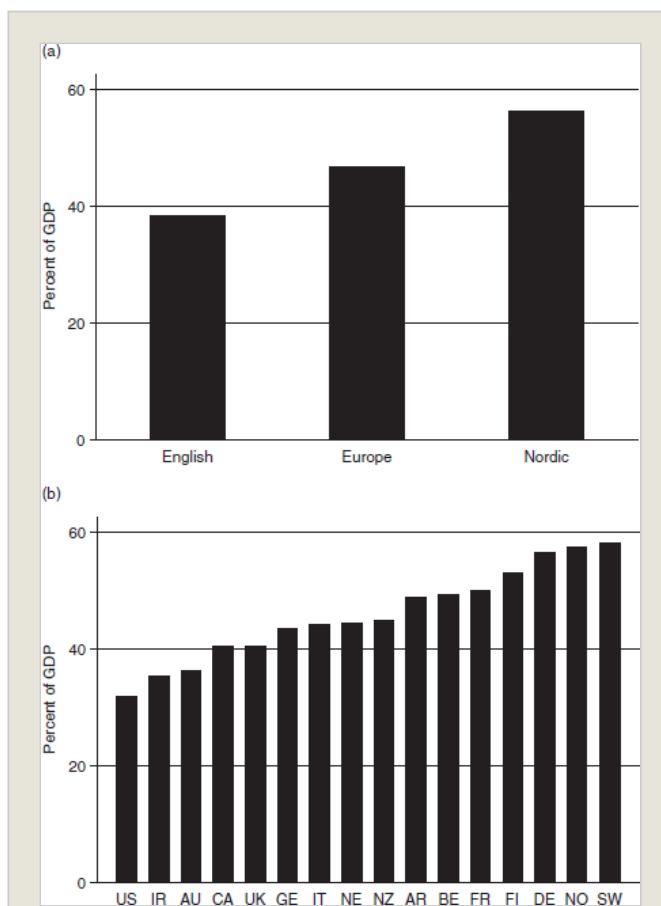
varies from an average of 56 percent of GDP in the Nordic countries to 47 percent of GDP in the EC countries, and 38 percent of GDP in the ES countries. Figure 12.1b shows these ratios by individual country. Notice that Japan and the United States are at the far low end of the scale, with government receipts of around 32 percent of GDP, roughly half of the level in the Nordic countries, which are grouped at the high end of the scale.² (In figure 12.1 all group averages are simple unweighted averages.)

The ratio of government receipts to GDP is, of course, very highly correlated with the ratio of government outlays to GDP ($r = 0.85$, spearman rank correlation = 0.85). Figure 12.2a shows that total government outlays averaged 52 percent of GDP in the Nordic countries, 49 percent of GDP in the EC countries, and 38 percent of GDP in the ES countries.³ Once again, when we look at the individual countries in figure 12.2b, we see that the United States is at the very low end of the scale while the Nordic countries are still grouped at the top of the scale.

The key difference in fiscal outlays across countries is in the levels of social expenditures to GNP, including both cash transfers and the public provision of social services. The average level of social outlays in GDP in the three groups of countries is shown in figure 12.3a and for individual countries in figure 12.3b.⁴ The correlation between total outlays to GDP and social expenditures to GDP is $r = 0.85$, and the Spearman rank correlation is 0.84.

In simple terms, the major fiscal differences across these countries, both in total tax collections and public outlays, lie mainly in regard to how these countries deal with social expenditures. The Nordic **(p.390)**

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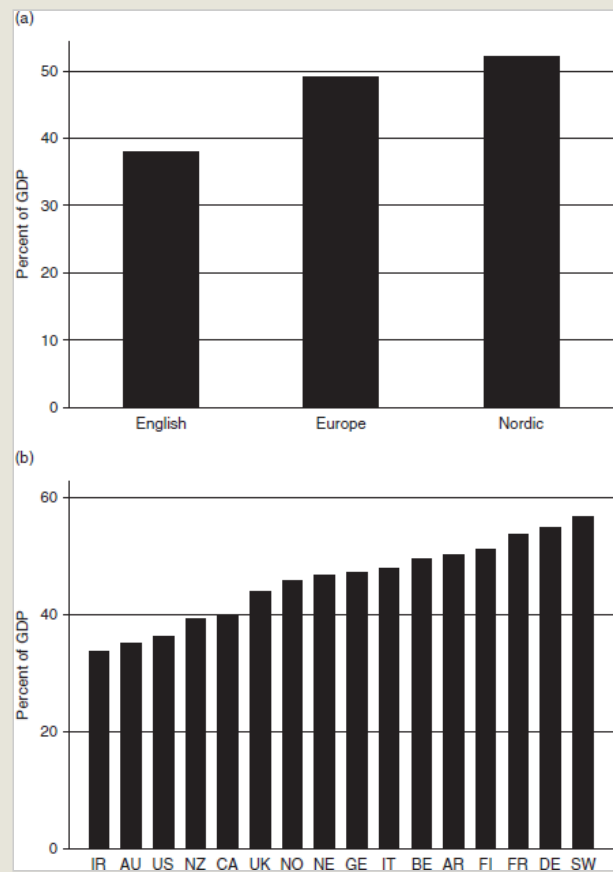


Figure 12.2 Government outlays as share of GDP: (a) high-income country groups; (b) individual countries compared. Nordic economies are Denmark, Finland, Norway, Sweden; European continental countries are Austria, Belgium, France, Germany, Italy, Netherlands; English-speaking countries are Australia, Canada, Ireland, New Zealand, United Kingdom, United States

(p.393) countries are high-tax countries, financing a high level of social expenditures. The English-speaking countries are low-tax countries, financing a much lower level of social expenditures. The European continental countries fall in the middle.

12.3 Characteristics of Social Outlays

Public sector social outlays are divided between cash transfers, direct government provision of services, and active labor market policies (e.g., job training and government hires under jobs programs). Cash transfers include transfers to retirees (pensions and survivor benefits) plus cash transfers to working-age households on the other. Government social services are divided between health and non-health services (e.g., child care and disability care). The breakdown of these main categories of social outlays is as shown in table 12.1. I will refer to the sum of the first two categories (cash transfers plus direct government provision of services) as direct public social outlays. These plus spending on active labor market programs equal total public sector outlays.

We see that the Nordic countries are distinctive not only in their overall high level of social expenditures but also in their high direct provision of non-health social services, such as child care. These directly provided services are important not only for the services themselves but also for the public employment positions that they represent. The Nordic countries hired many otherwise hard to employ individuals into the government social sectors in the past twenty years as part of their labor market strategy.

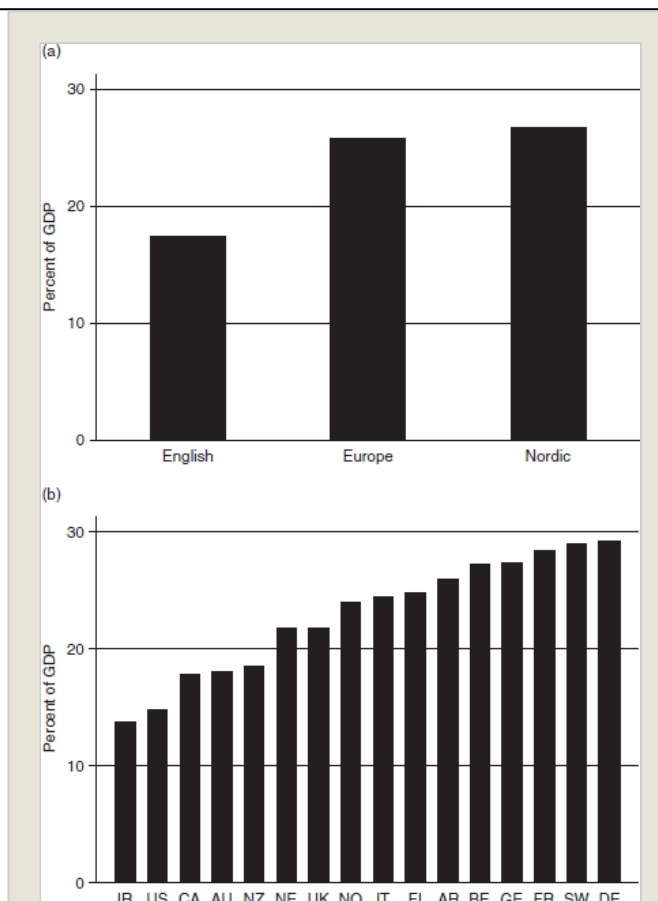


Figure 12.3 Public social expenditures as share of GDP: (a) high-income country groups; (b) individual countries compared. Nordic economies are Denmark, Finland, Norway, Sweden; European continental countries are Austria, Belgium, France, Germany, Italy, Netherlands; English-speaking countries are Australia, Canada, Ireland, New Zealand, United Kingdom, United States

Figure 12.1 Government receipts as share of GDP: (a) high-income country groups; (b) individual high-income countries compared. Nordic economies are Denmark, Finland, Norway, Sweden; European continental countries are Austria, Belgium, France, Germany, Italy, Netherlands; English-speaking countries are Australia, Canada, Ireland, New Zealand, United Kingdom, United States

Table 12.1 Public-sector social outlays (share of GDP)

Country	Cash transfers	Direct provision of services	Active labor market policies	Total public sector social outlay
English-speaking	9.8	7.2	0.4	17.4
Europe	16.8	8.0	1.0	25.8
Nordic	14.2	11.4	1.2	26.8
United States	7.9	6.7	0.2	14.8

Source: OECD, *Social Expenditure Database, 1980–2001* (2004: www.oecd.org/els/social/expenditure).

Note: Values cited are for 2001.

(p.394) The low level of public social expenditures in GDP in the United States compared with the other countries is offset in part by a higher level of private social expenditures in GDP. The United States has given greater weight to private over public outlays in several categories of social spending, including health care, pensions, and child care. US private outlays include 5.0 percent of GDP for health expenditure and 4.7 percent of GDP for private pension savings, compared with just 0.1 and 0.9 percent of GDP, respectively, for the Nordic countries.⁵

One of the important features of private outlays, of course, is that they are not redistributive in nature. They contribute little if at all to poverty reduction. Another feature seems to be the low efficiency of private spending on health, for reason of market failure in the health sector first elaborated by Arrow (1962). We will note from the evidence below that the United States does not get much “bang for the buck” out of its heavily private health spending. When public and private outlays are added together, the total US social outlay is 25.1 percent of GDP (14.8 percent public and 10.3 percent private), which is still considerably below the level of the European continental countries and the Nordic countries⁶.

12.4 Social Outlays and Poverty

The first important observation about the Nordic social welfare systems is that they succeed in reducing poverty. The OECD collects comparative data on inequality in three relevant ways: (1) the share of the population living at less than 50 percent of the average household income (standardized by household size), (2) the share of disposable income (after-tax and transfer) received by the bottom 20 percent of the population, and (3) the Gini coefficient on income distribution.⁷ As shown in table 12.2, on all accounts the Nordic countries rank as the most equal

Table 12.2 Inequality and poverty indicators

Country	Poverty rate	Share of disposable income to lowest quintile	Gini coefficient
English-speaking	12.6	7.3	32.0
Europe	9.0	8.4	28.0
Nordic	5.6	9.7	24.7
United States	17.1	6.2	35.7

(p.395) of the three groups of countries, with the difference in means of these measures across the groups highly significant. The average poverty rate in the Nordic countries in 2004 was just 5.6 percent of households, compared with 9 percent in Europe and 12.6 percent in the English-speaking countries. The United States, among the richest of all the countries in per capita GDP, has also by far the highest poverty rate, at 17.1 percent of households.

The cross-country evidence suggests that public social spending does reduce poverty. A simple regression of the poverty rate on public social outlays and private social outlays shows the negative effect of public social outlays on poverty (table 12.3, regression 1). Next we separate public social outlays into direct public social outlays and active labor market expenditures, and find that both the direct outlays and the active labor market policies have a significant negative effect on the poverty rate while once again the private social expenditures have no statistically significant effect (regression 2). When we divide the direct public outlays into cash transfers and the public provision of

Table 12.3 Regression results

	(1)	(2)	(3)	(4)	(5)
Dependent variables	Poverty rate	Poverty rate	Poverty rate	Disposable income of bottom quintile	Disposable income of bottom quintile
<i>Independent variables</i>					
Public social outlays	-0.63** (-4.61)				
Private social outlays	-0.19 (-0.76)	-0.09 (-0.42)	-0.07 (-0.30)	0.16 (0.23)	-0.01 (-0.08)
Direct public social outlays		-0.39** (-2.76)		0.09* (2.00)	
Active labor market expenditures		-4.47** (-3.25)	-4.08** (-2.69)	1.56** (3.29)	1.41** (3.04)
Cash transfers			-0.34* (-2.09)		0.51 (0.97)
Public services			-0.57* (-1.86)		0.21** (2.41)

Notes: *t*-Statistics listed in parentheses. * Indicates significance at 10 percent level. ** Indicates significance at 5 percent level.

(p.396) services, both show up as reducing the poverty rate (regression 3). When we regress the disposable income share of the bottom quintile on public and private outlays, we again find that the public outlays and active labor market policies boost the share of income in the bottom quintile, while private social outlays have no statistically significant effect on the income share of the poorest 20 percent (regression 4). We also find that the direct provision of public services has a larger effect than cash transfers on the income of the bottom quintile (regression 5). Figure 12.4a shows the added-variable plot of the poverty rate against the share of public sector outlays in GDP, based on regression 1 in table 12.3. The strong negative effect of public social outlays on poverty is clearly evident. Figure 12.4b shows the same for private social outlays, which clearly have no strong effect in reducing poverty rates.

12.5 Labor Market Outcomes of the Nordic Social Welfare Policies

We now turn to the possible adverse consequences of the high levels of social expenditure in the Nordic states. This section examines the patterns of employment, unemployment, and hours of work per employee. Later sections examine other possible adverse effects, on the standard of living, fiscal policy, and other indicators of economic performance and well-being. In general, we find no evidence for any significant adverse economic effects of high levels of public social outlays and government revenue collection.

The employment rate is the number of employed people divided by the population of working age, taken to be ages 15 to 64. The surprising fact, to be seen in table 12.4, is that the Nordic countries have maintained an even higher employment rate than the English-speaking countries.⁸ The ES countries in turn have a higher employment rate than the EC countries, which is as expected given the chronic concerns about labor market rigidity and high unemployment in continental Europe. The main message is not to lump the Nordic states and the continental states with regard to employment outcomes.

The very high employment rate of the Nordic states would appear to reflect two important facts about Nordic economic policies. First, especially during the past ten years, social support for the working-age population has been tied to active labor market policies whereby recipients of social support are required to seek employment. Second, the state has acted as an important employer of last resort. Many older, **(p.397)**

(p.398)

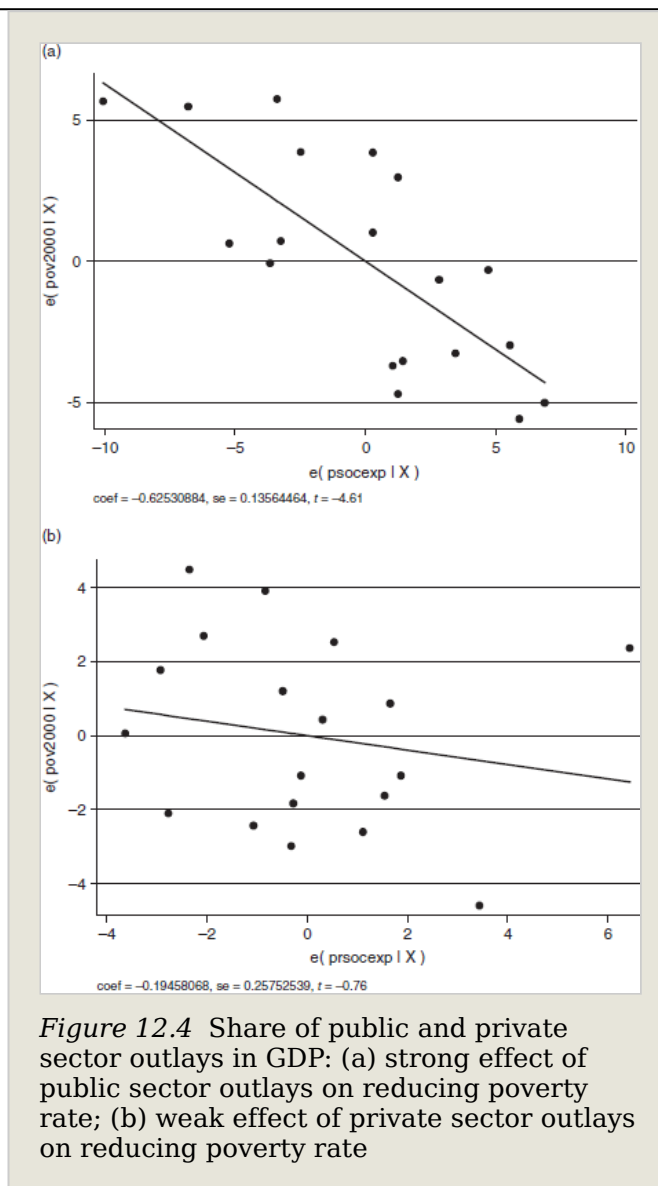


Figure 12.4 Share of public and private sector outlays in GDP: (a) strong effect of public sector outlays on reducing poverty rate; (b) weak effect of private sector outlays on reducing poverty rate

Table 12.4 Employment

Region	Employment rate (share of working age population)
English-speaking	72.4
Europe	68.9
Nordic	73.7

Source: OECD *Factbook*, 2006.

lower skilled, and partially disabled workers are employed in the public sector, and especially by local governments, in the provision of public-sector social services, including day care, health care, and support for the disabled population.⁹ The rise of public employment is exemplified by the case of Sweden, where the public employment swelled from around 22 percent of the employed in 1970 to around 38 percent of the employed today, with most of that increase taking place in local government positions in the social sector. By contrast, the US public employment rose only slightly, from around 22 percent of the employed in 1970, roughly the same as in Sweden, to around 26 percent today.

Unemployment rates are shown in figure 12.5a and b. The European continental states have had chronically high unemployment rates, as shown. The Nordic unemployment rates are lower than in the EC countries, and slightly higher than in the ES countries. This is due solely to Finland, where unemployment rates remain relatively high. The unemployment rates in Denmark, Norway, and Sweden are comparable to the low rates in the ES countries. The high EC unemployment rates are generally attributed to relatively fixed real wages, often supported by generous unemployment benefits but without work requirements. Unlike the Nordic states, it appears that the EC states are less rigorous in enforcing work requirements on hard to employ workers, and are less willing or able to hire such workers directly into the public sector.¹⁰

The main place where the labor market outcomes differ between the lower taxed ES and the higher taxed EC and Nordic states is in hours of work per employee. The English speaking countries work roughly 200 hours per year more than their counterparts, and this does seem to be statistically related to the level of social expenditures and taxation. The long working hours of the United States are *not* an obvious outlier **(p.399)**

(p.400) compared with the other English-speaking countries; the pattern of greater working hours is common throughout the English-speaking countries.¹¹ The difference in working hours results mainly from differences in three areas: paid vacation time—which averages around six weeks in Europe compared with two weeks in the United States—paid maternity leave—which is typically twelve weeks in Europe and without public guarantee in the United States—and hours of work per week—which are typically under forty hours in most of Europe. These differences are probably due in significant part to the higher effect rates of taxation on labor income in Europe, though other factors are also important (unionization, public policy views on maternity, etc.).¹²

The welfare consequences are complex. On the one hand, neoclassical theory suggests a straightforward deadweight loss to the shift out of labor in to leisure as the result of high rates of labor taxation. On the other hand, the provision of paid maternity leave may, in the same manner as mandatory primary education, provide a social guarantee of well-being for newborns. Similarly societywide choices on vacation time and weekly working hours can prevent the “rat race” syndrome of overwork that results from a zero-sum (and hence

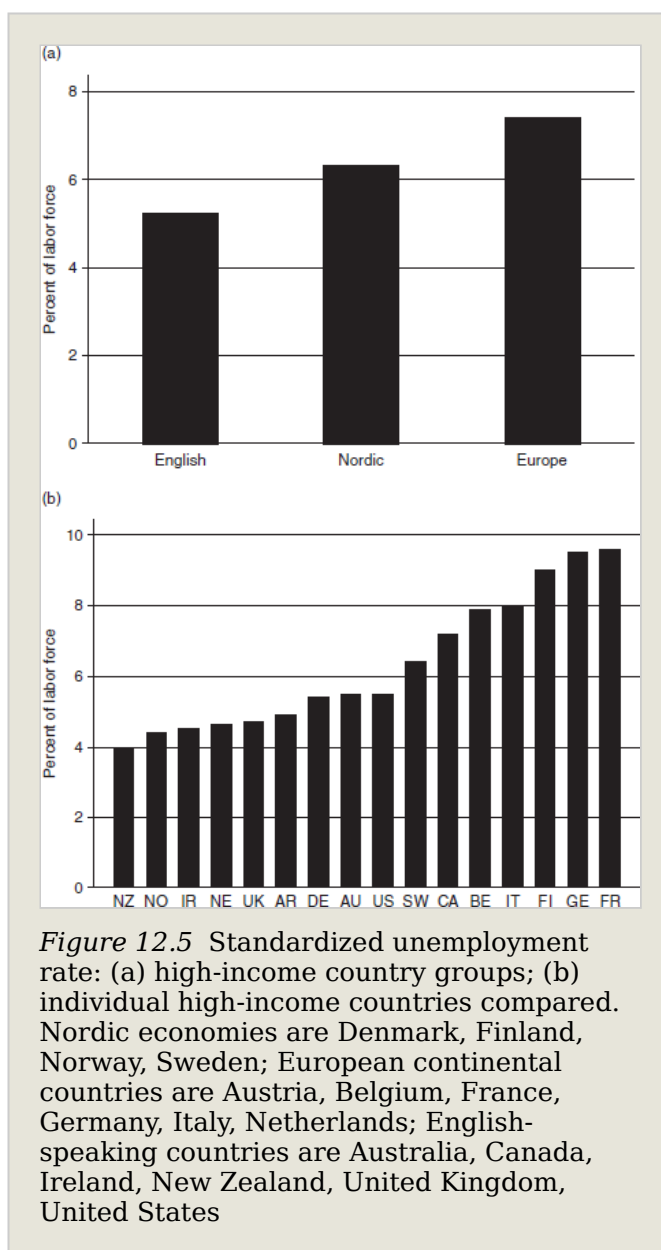


Figure 12.5 Standardized unemployment rate: (a) high-income country groups; (b) individual high-income countries compared. Nordic economies are Denmark, Finland, Norway, Sweden; European continental countries are Austria, Belgium, France, Germany, Italy, Netherlands; English-speaking countries are Australia, Canada, Ireland, New Zealand, United Kingdom, United States

inefficient) competition among workers with each trying to earn a higher income than their peers. Finally socially agreed reductions in work hours and increases in vacation time may facilitate a socially optimal coordination of increased leisure time in a way that market forces alone may be unable to accomplish, when the value of leisure time of each individual depends on the leisure time taken by others.

12.6 Social Spending and Per capita Income

As a matter of simple averages, the Nordic countries have a higher average per capita GDP than the English-speaking countries, with the European continent countries coming in third. Norway is the highest income country in the sample, followed by the United States. One could rightly argue that Norway's hydrocarbon income make it something of a special case, giving an artificial boost to the income of the Nordic countries, but one could make similar cases about the especially favorable endowments of many of the countries in the sample, including the United States. What is true, at the least, is that the per capita income of the Nordic countries is not in any obvious sense "crippled" by the high social expenditure, and per capita income may even be **(p.401)** higher than lower taxed English-speaking economies. It is interesting to note that if both Norway and the United States are removed from the sample as high-income special cases, then the remaining three Nordic countries still have a slightly higher average per capita income (\$47,008) than the remaining five English-speaking countries (\$46,279), though the difference is not statistically significant. Despite almost 20 percentage points of difference in tax take as a share of GDP, GDP per working-age population is essentially the same!

The standard measures of GDP per person perhaps skew the deck against economic well-being in the Nordic countries, since GDP does not count the value of the greater leisure time. As a rough measure, let us calculate a "full GDP," inclusive of the value of leisure. As in Gordon (2006), we put the value of an hour of leisure time as equal to two-thirds of the hourly labor compensation, which we estimate as equal to three-fourths of the value of GDP per labor hour.¹³ These assumptions give us the value of an hour of leisure as equal to one-half of GDP per labor hour. The total value of leisure time in the economy is then equal to 0.5 times GDP times (leisure hours/labor hours). This sum is added to total GDP to get the full GDP, which is then divided by the working-age population. This correction, of course, widens the lead of the Nordic countries. Indeed, even the European Continental countries now outpace the English-speaking countries in full GDP per working-age population.

The United States still ranks above almost all the other countries whether the measure is GDP or full GDP per working-age population. Indeed, the United States ranks second only to Norway. One might argue therefore that the US "system" is more productive than the alternatives. This does not square easily with the fact that other relatively liberal economies (e.g., Australia, Canada, New Zealand, and United Kingdom) do not obviously outpace their counterparts.¹⁴ The US advantage, just as Norway's advantage, may have to do with a combination of extraordinary resource endowments (land, energy, minerals, etc.) as well as its economic system.

12.7 Per capita Income of the Rich and Poor

Average per capita income should not be the beginning and end of welfare comparisons. With very different patterns of income distribution, it is important to compare the average income levels at various points of the income distribution as well. A simple way to do this, without access to extensive and comparable household data sets, is to **(p.402)**

Table 12.5 Income distribution

Region	Bottom quintile	Middle quintiles	Top quintile
English-speaking	7.3	54.1	38.6
Europe	8.4	54.8	36.8
Nordic	9.6	56	34.4

Source: Forster and Mira d'Ercole (2005).

Note: Most data cited here are for 2000.

approximate per capita income for different quintiles of the population. Household disposable income for the top 20 percent, middle 60 percent, and bottom 20 percent of the households is shown in table 12.5 for the three groups of countries, as usual taking simple averages of the income shares of the countries in the respective categories.

The per capita income level of the bottom quintile is approximately equal to the economywide average per capita income level multiplied by income share of the bottom quintile divided by 20. Thus, in the English-speaking countries, with an average per capita income per working-age population of \$48,456, the average per capita income of the bottom quintile is approximately \$17,686 ($=7.3/20 \times \$48,456$). (The approximation arises, among other things, because the income quintiles are for all ages, not only working ages.)

The bottom quintile comes out way ahead in the Nordic countries. The average per capita income of the working age population in the bottom quintile, estimated as just described, comes out to be \$24,465 for the Nordic countries, \$19,066 for the European continental countries, and just \$17,553 for the English-speaking countries. Once again we see that the English-speaking countries are indeed tough places to be poor! Moreover the United States, with the second-highest GDP per working-age population, comes out in the middle of the pack in terms of per capita income of the bottom 20 percent (\$18,395), behind all four of the Nordic countries.

12.8 Are There Other Adverse Consequences of the Social Welfare State?

Here are some additional alleged disadvantages of the social welfare state, at least as argued by US supply-siders and by the laissez faire tradition.

(p.403) *The Hayek-Friedman freedom hypothesis* Hayek raised the idea that large-scale state involvement in the economy would be the road to serfdom, namely to the diminution and even collapse of political liberties.¹⁵ Friedman has written about taxation as coercion and therefore antithetical to a free society.

Fiscal distress It has been hypothesized that the social welfare state would lead to chronic fiscal crisis, evidenced by chronic fiscal deficits and high levels of public indebtedness relative to GDP.

Household saving rate It is argued that high rates of taxation reduce the incentives to save and invest.

Innovation It has been asserted that high tax rates will stifle entrepreneurship and innovation, with a consequent decline in the rate of total factor productivity growth, patenting, and other outcomes of innovative activity.

Let us consider the basic evidence.

The Hayek-Friedman hypothesis has been disproved by experience. All the Nordic countries remain vibrant democracies, and all score very well on every widely known indicator of governance. As shown in table 12.6, the countries tend to be *less* corrupt on average (as scored by the Transparency International corruption perceptions index) than the other countries. The English-speaking countries rank second, and the European continental countries rank third. The Nordic countries similarly score better than the other groups on various measures of

Table 12.6 Governance indicators

Region	Global Competitiveness Report ^b			
	Transparency International CPI ^a	Overall score	Contracts	Public institutions
English-speaking	8.4	13.5	13.2	12.5
Europe	7.6	25.8	23.7	21.5
Nordic	9.3	4.3	7.5	7.5

Source: Transparency International (2005); GCR from Lopez-Carlos et al. (2006).

Notes: The TI scores are up to 10 (with higher signifying less corrupt). The Global Competitiveness Report numbers indicate the ranking of each country in the group, with rank equal to 1 being the best score, so that lower numbers signify better performance.

(a.) Index is scored from 0 to 10 (higher score indicates less corruption). Values cited are for 2005.

(b.) Average ranking. See Lopez-Carlos et al. (2006).

(p.404) public institutions in the World Economic Forum's *Global Competitiveness Report*. On average the Nordic countries tend to have the best governance scores or ranks, followed by the English-speaking countries, and then the continental countries, though the differences in means are not significant. There is no evidence that higher levels of taxation as a share of GDP or higher social outlays as a share of GDP are conducive to higher corruption or weaker property rights.

The fiscal distress hypothesis is also decisively rejected by the evidence. Table 12.7 shows why this is so. The countries are ordered, lowest to highest, regarding the net liabilities of the public sector as a share of GDP. Amazingly, three of the four Nordic countries have positive government financial net worth (i.e., negative net liabilities), and the fourth, Denmark has only small net liabilities as a share of GDP

Table 12.7 Fiscal distress

Country	Net government liabilities (percentage of GDP, 2004)	Current fiscal imbalance (percentage of GDP, 2004)
Norway	-111.2	11.7
Finland	-47.5	1.9
Sweden	-5.7	1.6
Australia	0.7	1.3
New Zealand	4.8	5.9
Ireland	12.0	1.6
Denmark	12.1	1.7
Switzerland	25.4	-1.1
Canada	31.1	0.7
Spain	33.6	-0.2
United Kingdom	36.9	-3.3
Netherlands	37.8	-2.1
Portugal	40.3	-3.2
Austria	41.7	-1.2
France	44.4	-3.7
United States	45.1	-4.7
Germany	54.5	-3.7
Japan	82.2	-6.3
Belgium	86.5	-0.1
Italy	97.7	-3.5
Greece	97.9	-6.9

Source: OECD *Economic Outlook*, 2006.

(p.405) (12 percent). The English-speaking countries, generally speaking are in the middle of the pack, while the European continental countries have very large net financial liabilities in

many cases, notably Belgium and Italy. The same holds true regarding current fiscal imbalances, shown in the second column of the table. All four of the Nordic states had budget surpluses in 2004, while all of the continental states have deficits. The English-speaking countries are again in the middle, with four out of six in surplus and two in deficit (with the United States running the largest deficit as a share of GDP among the English-speaking countries).¹⁶

It is interesting that while both the Nordic countries and the European continental countries have high levels of social spending, only the continental countries have chronic fiscal distress. The Nordic states have matched their social ambitions with their tax collections, while the European continental countries have not. Social spending is nearly the same across the two groups, but the EC countries have government receipts to GDP that average 17 percentage points lower than those in the Nordic countries.¹⁷ It seems that the EC countries are conflicted about where to turn: they are pulled to high levels of social spending, but then pressed for tax cuts.

With regard to household saving the evidence runs overwhelmingly against the hypothesis that high rates of taxation and social outlays diminish the rate of household saving. While there are no doubt some important measurement issues here, to get a precise comparative account, the overwhelming evidence is that the English-speaking countries have the lowest household saving rates, while both the Nordic and EC countries have similar and higher net household saving rates. It would be therefore interesting to learn whether the free-wheeling competitive environment of the English-speaking countries actually contributes culturally to the credit-card, debt-ridden society. But this is not the place to decide such a weighty issue; we can seek only to refute the common claim that tax cutting is somehow conducive to higher household saving rates.

One of the striking facts about the Nordic states is their very high rate of technological excellence. Sweden and Finland, of course, prosper on their ICT sectors, notably led by Ericsson and Nokia, respectively. Table 12.8 shows the ranking of countries in the World Economic Forum Technology Index, which is built on evidence of innovation, R&D, and mobilization of information and communications technology. The Nordic countries score exceptionally high on the technology index. **(p.406)**

Table 12.8 Technology and R&D

Region	World Economic Forum Technology Index ^a
English-speaking	16.2
Europe	24
Nordic	6

Source: Lopez-Carlos et al. (2006).

(a.) Average ranking.

They are heavy investors in both R&D and higher education, and they have very high rates of patents per capita as well.¹⁸

12.9 Is the Nordic Model Transferable and Sustainable?

The Nordic commitment to the social welfare state is long-standing, and dates back at least to the post-World War II political scene. Social Democrats have governed in northern Europe for a preponderance of years since 1950. Social spending as a percentage of GDP has been relatively

high in the Nordic countries for at least forty years. In this sense, there is a long-standing Nordic model of social democracy. We have shown that the Nordic model of high social spending has not led to long-term political or economic deterioration. The Nordic countries tend to outperform most of the other countries on most economic and governance indicators.

There are still important questions regarding the transferability of the Nordic model. There is probably little room for doubt that Nordic ethnic homogeneity has been an important enabling social factor in the success of the social welfare state. In a wonderful series of articles, Alesina and colleagues have shown that social spending tends to be highest where social and racial cleavages are the smallest. This is true across US states and apparently across countries as well. White Americans living in states with higher proportions of African-Americans, for example, seem to be much less likely to support high levels of social spending (Alesina et al. 2001). The authors summarize matters as follows:

Racial discord plays a critical role in determining beliefs about the poor. Since minorities are highly over-represented amongst the poorest Americans, any income-based redistribution measures will redistribute particularly to **(p.407)** minorities. The opponents of redistribution have regularly used race based rhetoric to fight left-wing policies. Across countries, racial fragmentation is a powerful predictor of redistribution. Within the U.S., race is the single most important predictor of support for welfare. America's troubled race relations are clearly a major reason for the absence of an American welfare state. (2001: 4)

The Nordic model may itself come under stress if inward migration into these countries, and a relatively high fertility rates of immigrant populations, lead to a sharp rise in normative populations in the Nordic countries. This important issue, however, is well beyond the scope of this chapter.

Globalization too could undermine the ability to levy high tax rates on a sustainable basis. The Nordic countries have wisely kept the rate of taxation on capital relatively low, garnering the bulk of tax revenues through the value-added tax, and other taxes on goods, services, and wage income. Tax policy favorable toward capital has enabled the Nordic states to combine high rates of taxation with internationally open capital markets. Still, we can wonder whether increased labor migration and the high share of taxation that falls on human capital, if not on corporate capital, will eventually undermine the ability of the Nordic states to collect the requisite levels of GNP needed to sustain the social welfare state. Such doubts have been around for a long time, and have not really materialized. Yet increasing globalization could still undermine the tax base of the Nordic states.

12.10 Conclusions

The comparisons among Nordic, European continental, and English-speaking countries offered in this chapter made no attempt to formulate precise models of the Nordic social welfare state, or to estimate precise parameters regarding labor force participation, hours worked, poverty rates, and other critical variables. The aim was much simpler: to show that highly ideological claims made against the social welfare states of Scandinavia are simply off the mark. The "euro-pessimism" in many parts of the continental Europe, and the claim that Anglo-Saxon liberalization is crucial to economic well-being, is belied by the persistent high performance of the Nordic economies. For decades these economies have maintained high levels of GNP per

worker, low rates of poverty, high rates of innovation, and high levels of labor force participation.

(p.408) The continental European countries seem to be caught, in some ways, between two urges: the social welfare impulse of northern Europe, and the liberalizing influence of the Anglo-Saxon model. The result may actually be the worst of both worlds. The continental European countries spend like the Nordic states but do not generate the tax revenues to support that high level of social spending. They instead run chronic fiscal deficits. Moreover their labor market policies seem less geared to supporting the labor force participation of the less-skilled workers, as in the Nordic countries, and more geared toward simpler (and inefficient) labor market transfers, which raise unemployment rather than employ the lower skilled workers.

The evidence would at least suggest that countries such as France and Germany have a true choice: to raise tax collections further in order to sustain the social welfare state, or to cut spending in order to emulate the Anglo-Saxon model. Both paths seem viable, not only the liberalizing course favored by many of euro-pessimists. Of course, the long-term viability of the Nordic model (and of all other models) is open to question. The Swedish voters have just replaced the long-standing Social Democrats with a new Moderate government, one that is intent at least at trimming some aspects of the social democratic state. Still, to paraphrase Mark Twain, rumors of the death of the social welfare state have been greatly exaggerated.

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Notes:

(1.) Netherlands in fact lies somewhere between the four Nordic states and the rest of the continental countries in social expenditures, and might plausibly have been grouped with the Nordic states.

(2.) OECD, *Economic Outlook*, no. 79. Numbers cited are for 2004.

(3.) OECD, *Economic Outlook*, no. 79. Numbers cited are for 2004.

(4.) OECD, *Social Expenditure Database 1980–2001*, 2004 (www.oecd.org/els/social/expenditure). Values cited are for 2001.

(5.) Numbers are for 2001 and are based on Adema and Ladaique (2005).

(6.) OECD (2004), *Social Expenditure Database 1980–2001* (www.oecd.org/els/social/expenditure). Numbers cited are for 2001.

(7.) Data on all three indicators are taken from Förster and Mira D’Ercole (2005).

(8.) *OECD Factbook 2006: Economic, Environmental and Social Statistics* (OECD 2006b).

(9.) See, for example, “Disability programs in need of reform,” *OECD Policy Brief*, March 2003.

(10.) Data on unemployment rates from OECD *in Figures*, 2005 edition. Accessible online at <http://www.oecd.org/infigures/>. Numbers cited are for 2004.

(11.) For data on average working hours, see OECD *Productivity Database*, January 2006.

(12.) For a discussion of the differences in working hours, vacation, and maternity leave between Europe and the United States, see Alesina, Glaeser, and Sacerdote (2005), Meyers and Gornik (2004), United Nations (2006), and *Expedia.com* (2006).

(13.) Suppose that the labor share of GDP is 0.75. Then $wL = 0.75 \times GDP$, or $w = 0.75 \times GDP/L$, where L is total labor hours in the economy.

(14.) For data on labor productivity, see OECD *Productivity Database, 2006* (OECD 2006c).

(15.) In the original edition of *The Road to Serfdom*, the argument centered mainly on government ownership of industry and industrial planning. By 1976, however, von Hayek wrote the following in a forward to a reprinting of the book: “[S]ocialism has come to mean chiefly the extensive redistribution of incomes through taxation and the institutions of the welfare state. In [this] kind of socialism the [totalitarian] effects I discuss in this book are brought about more slowly, indirectly, and imperfectly. I believe that the ultimate outcome tends to be very much the same. ...” (pp. xx-xxi)

(16.) Data on net financial liability from OECD *Economic Outlook 79* (OECD 2005). Numbers cited are for 2004.

(17.) The simple average of government receipts as a percentage of GDP in 2004 was 46.7 for the EC countries, and 56.4 percent for the Nordic countries. Data on government receipts available from OECD *Economic Outlook*, No. 79 (OECD 2004).

(18.) Data on R&D expenditure, investment in knowledge, and tertiary attainment are available from the OECD *Factbook 2006: Economic and Social Statistics* (OECD 2006a).