

# Nordic welfare – a burden for economic growth?

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# Nordic welfare – a burden for economic growth? Storyline

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- Introduction: an old debate
- Economic wisdom and welfare state: why welfare states are not sustainable
- Nordic economic crises as evidence of that
- Post-crisis economic growth: Nordic economies stronger than expected
- What should we think? Should we give credit to welfare states?
- Concluding remarks

# Economic wisdom and welfare state

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- According to economic theory, welfare states should not be successful economies, because:
  - High taxes are detrimental to work and investment incentives (basic microeconomic reasoning)
  - Large public sectors create inefficiencies ('bureaucratic behaviour')
  - Benefit systems create dependencies which depress private initiative (public choice theory)
  - Welfare states may not be sustainable in longer run if people and firms become more mobile

# Nordic economic crises as evidence

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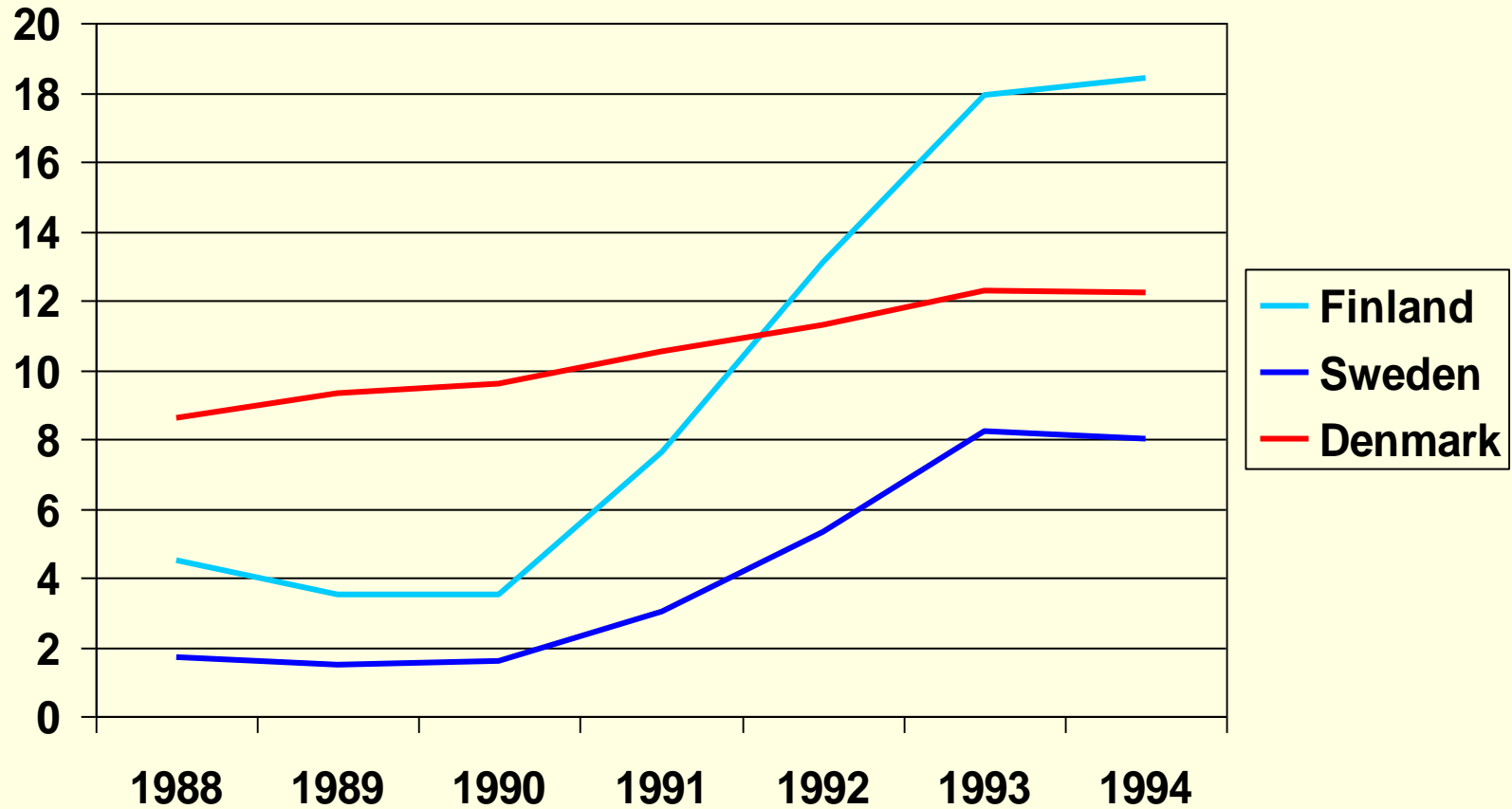
- Growing criticism of welfare states amongst experts and center-right politicians in the 1980s
- The deep economic recessions in the beginning of the 1990s in Nordic countries gave credibility to that criticism
- Increasing unemployment, dismal economic growth and worsening public finances made it clear that the Nordic economies were not on sustainable path
- Question: was the crisis just a temporary macroeconomic shock or a sign of a deeper structural problem?

# Economic wisdom and welfare state...

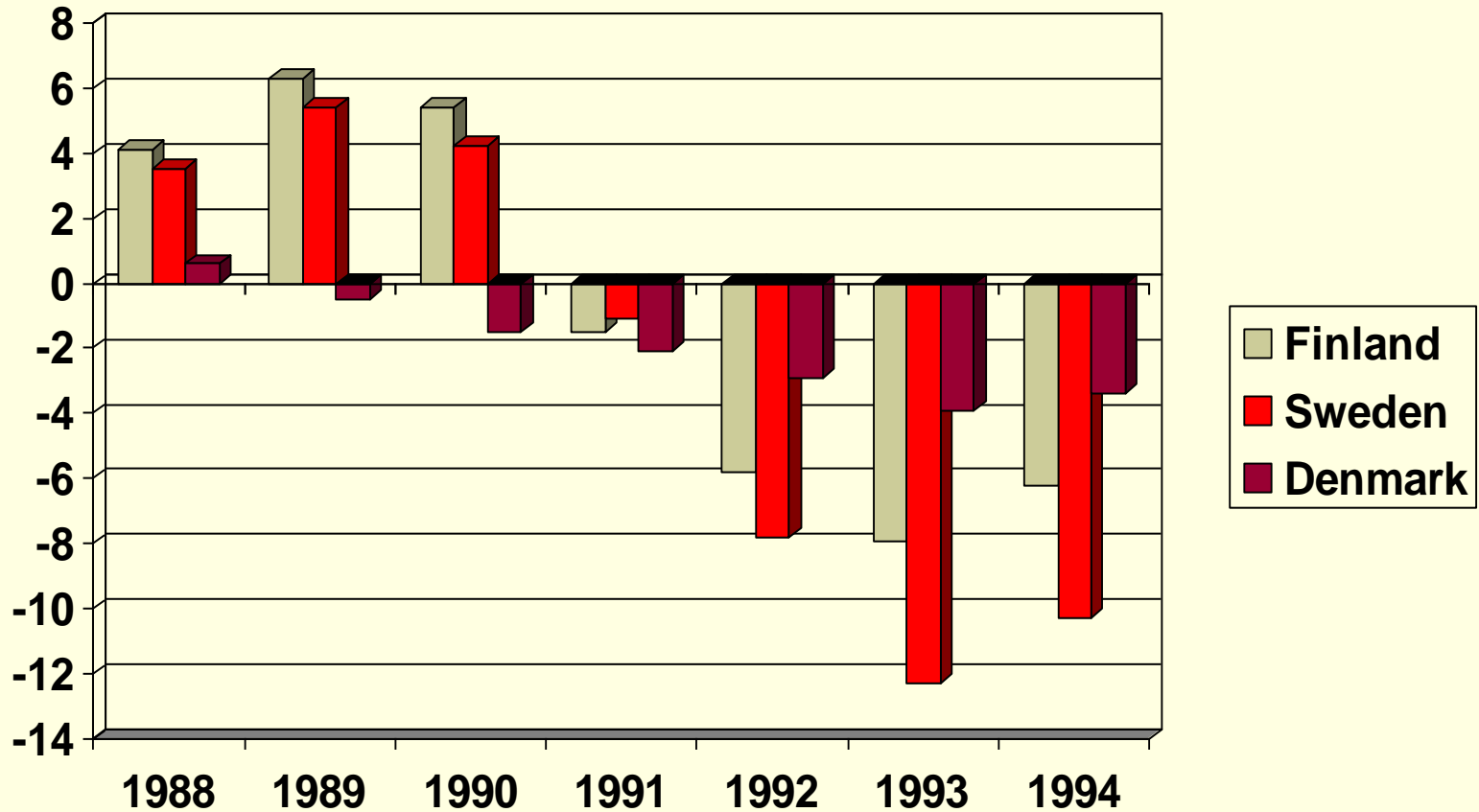
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- Welfare state critique has some empirical support:
  - Due to high taxes, shorter annual working hours in welfare states
  - Average labour productivity is lower in (comparable) countries with large public sector
  - Evidence of under-class and permanent non-employment
  - Increased mobility has already put welfare states on defensive and started tax competition

# Rising unemployment rate



# Deteriorating balance in public finances



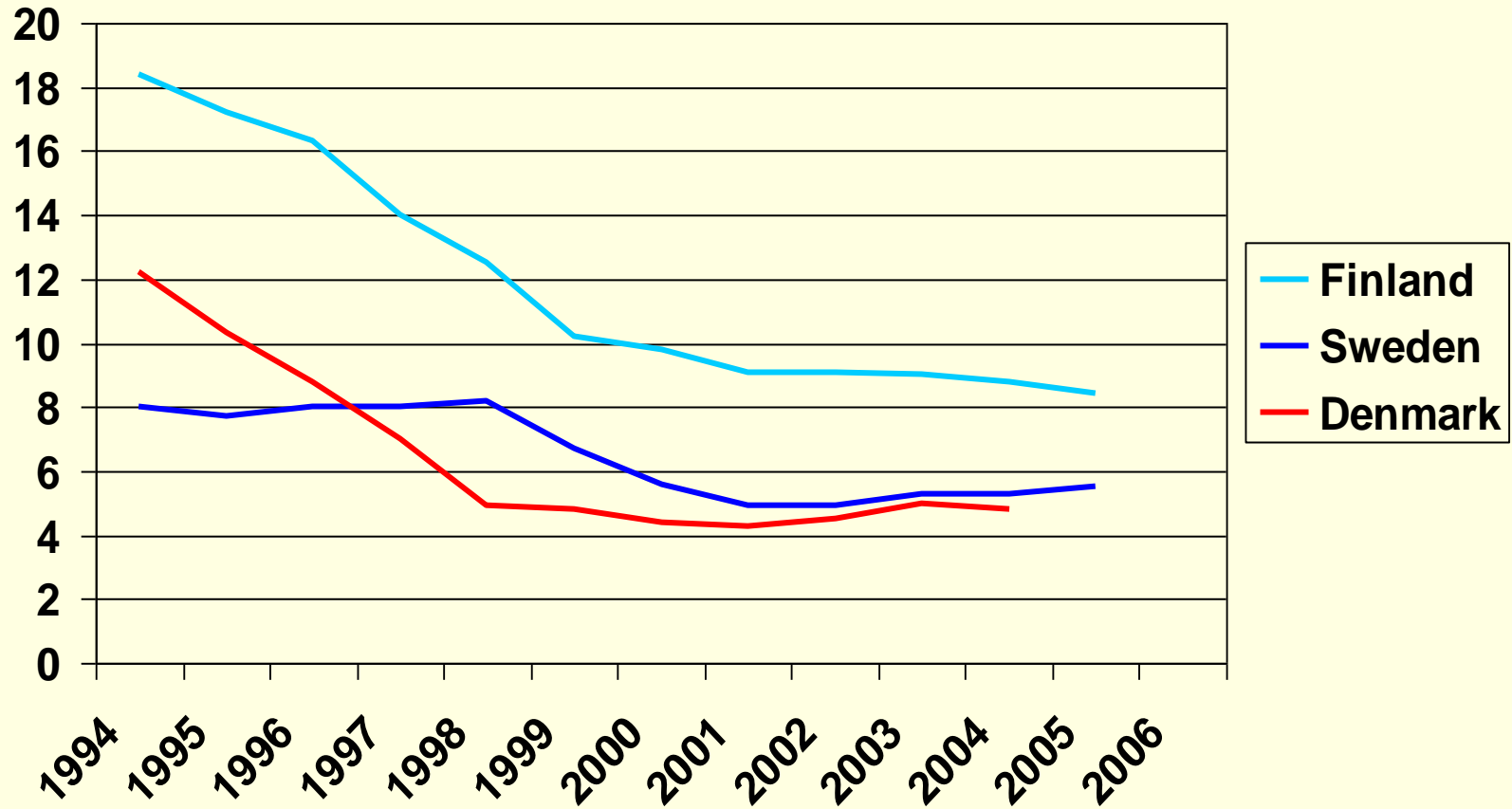
# Post-crisis economic growth

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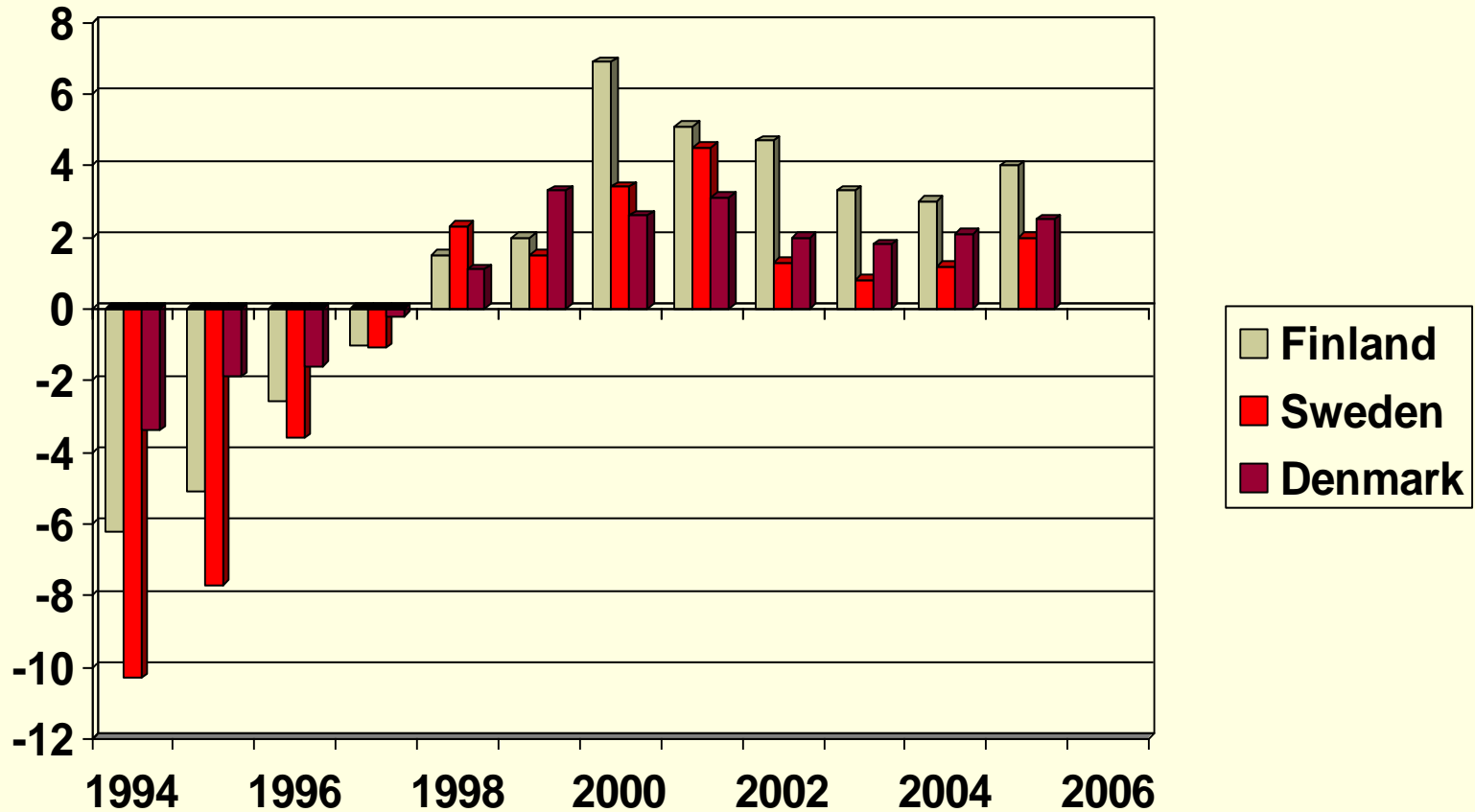
- (To the dismay of some critics (?)) the Nordic economies recovered from recession in 1993-94 and started a period of strong export-driven and non-inflationary growth
- In hindsight, the structural crisis of welfare states seems to have been a temporary economic shock



# Declining unemployment rates



# Improving balance in public finances



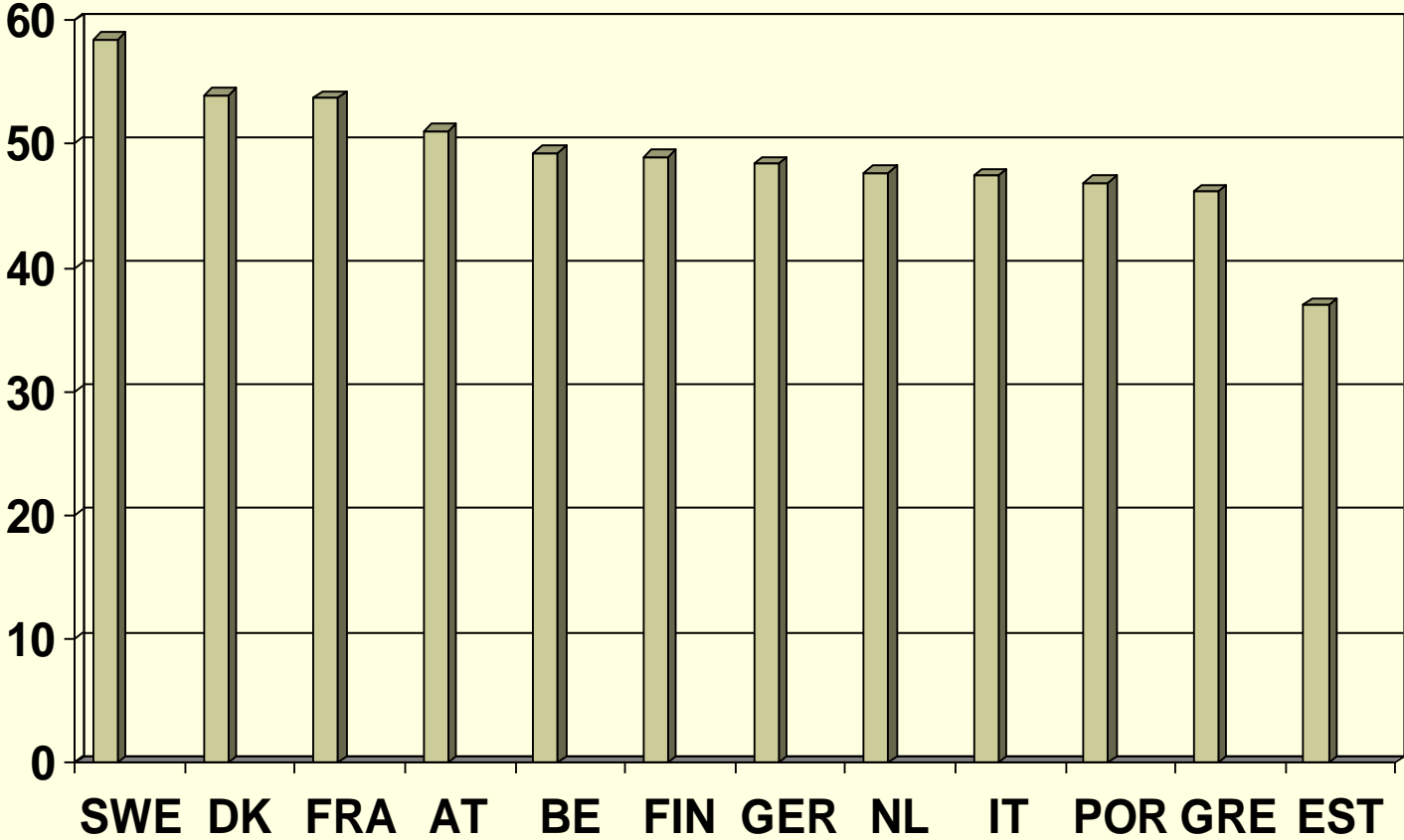
# What should we think?

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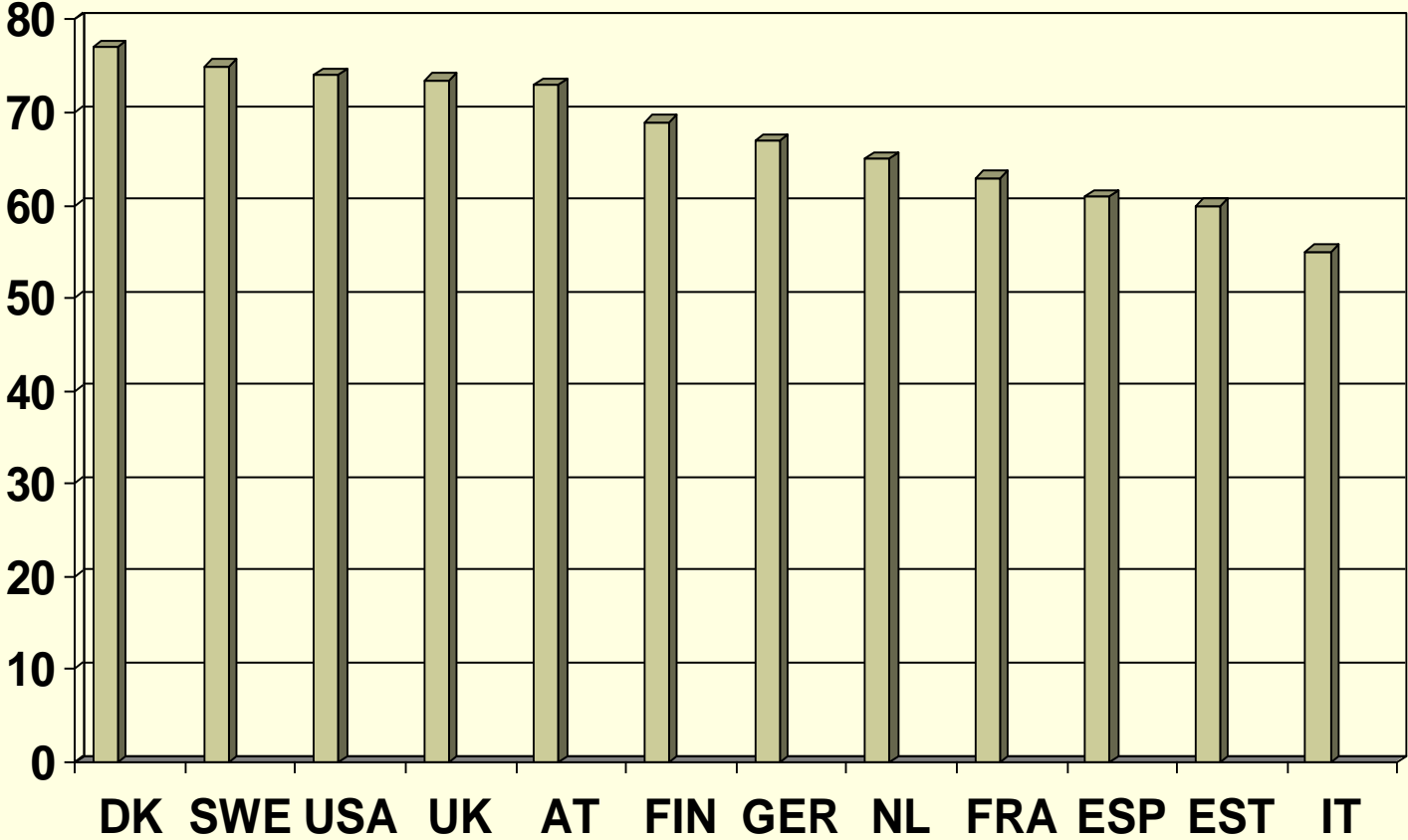
What is the role of welfare state in the economic recovery of the Nordics?

- *Of course*, the economic factors have been decisive
  - Macroeconomic policies
  - Structural and technological change
- *And*, welfare state has been trimmed and reformed
  - Tax reforms and cuts in benefit schemes; still the size of public sector more or less the same as in the 1980s
- *But*, the welfare state may have also contributed to growth by maintaining cohesion and improving capabilities

**Public sector is still large in welfare states ... but there are not big differences amongst the EU15**



# High employment rates in welfare states (Nordics & Austria) – equivalent to US & UK levels



# High employment rates and other strengths of the Nordic model

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- The most important critique against welfare states is that on bad work incentives; fails in Nordic countries where employment and participation rates are record high ... maybe the incentives are not that bad
- Large public sectors are typical to Nordics but they seem to be reasonably efficient in service production; they also contribute positively to labour force participation
- The Nordics have been able to adjust to more competitive environment (and faster than big EU countries) by reforming tax systems and investing in education and R&D

# Concluding remarks 1/2

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- Nordic welfare state has not been a burden for economic growth – why?
- Work-oriented systems like earnings-related benefits support employment
- Pragmatic approach to economic policy (like flat tax for capital income) have taken care of competitiveness and maintained tax revenues

# Concluding remarks 2/2

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- Challenges to Nordic welfare states are the same as for the all EU15 countries:
  - Ageing population and increasing fiscal burden
  - How to maintain competitiveness in global market place?
- ... but the Nordic countries are better prepared to face these challenges