The Myth of the Scandinavian Model

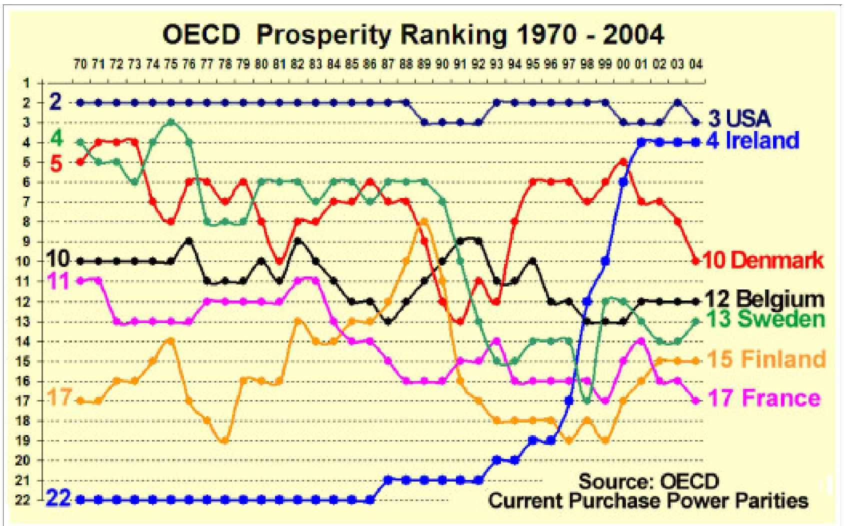
Economy

Version française ici

"America's social model is flawed, but so is France's," the Parisian newspaper Le Monde recently wrote. According to Le Monde Europe should adopt the "Scandinavian model," which is said to combine the economic efficiency of the Anglo-Saxon social model with the welfare state benefits of the continental European ones. The excessive praise for the Nordic model comes from Bruegel, a new Brussels-based think tank, "whose aim is to contribute to the quality of economic policymaking in Europe." The think tank is a Franco-German government initiative and is heavily funded by EU governments and corporations. In October Bruegel published a study "Globalisation and the Reform of European Social Models" [pdf] propagating the Nordic model.

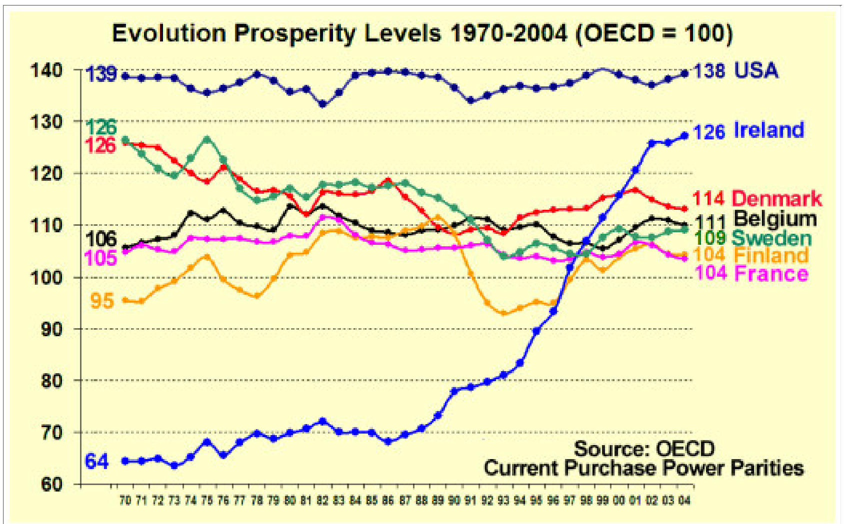
A paper from the economics department of Ghent University does the same. This paper, Fiscal Policy Employment and Growth: Why is the Euro Area Lagging Behind, was also subsidized by the government. Their paper compares the performances of Scandinavian policies those of the other EU economies. To proove their case, the authors arbitrarily eliminated Ireland, Spain and Portugal (three of the four best performing EU economies) from their EU country list and added oil-producing non-EU member Norway tho their Scandinavian selection. (over 20% of Norway's GDP is based on income from oil). It is hardly imaginable that professors of one of Belgium's major universities would not be aware of how this arbitrary selection must distort the results. Hence one must read their text as an ideological pamphlet rather than a scientific study...

The implosion of the welfare state



However, despite Bruegel, distorted academic studies and the European media's praise, the efficiency of the major Scandinavian economies is a myth. The Swedish and Finnish welfare states have been going through a long period of decline. In the early 1990s they were virtually bankrupt. Between 1990 and 1995 unemployment increased five-fold. The Scandinavian countries have not been able to recover.

In 1970, Sweden's level of prosperity was one quarter above Belgium's. By 2004 Sweden had fallen to 13th place from 4th in the prosperity index, just behind Belgium.



According to OECD figures, Denmark was the 5th most prosperous economy in the world in 1970, immediately behind Switzerland and the United States. In 2004, Denmark was 10h.

Finland did badly as well. From 1989 to 2004, while Ireland rose from 21st to 4th place, Finland fell from 8th to 15th place.

Together with Italy, these three Scandinavian countries are the worst performing economies in the entire European Union. Rather than taking them as an example, Europe's politicians should shun the Scandinavian recipes.

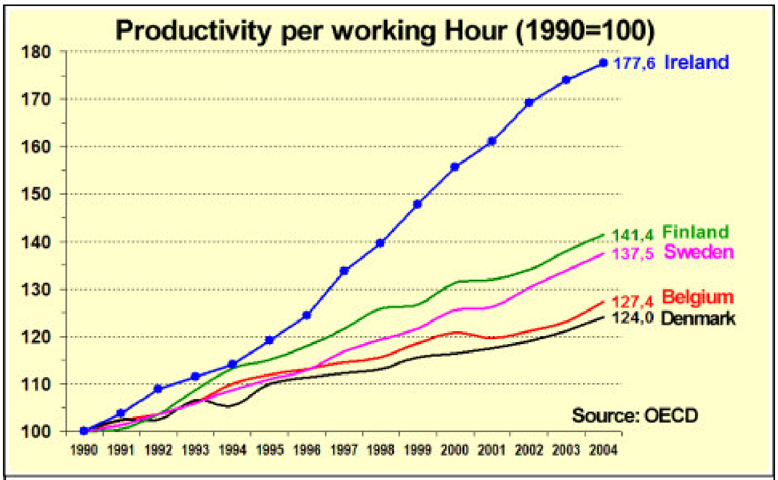
Jobs

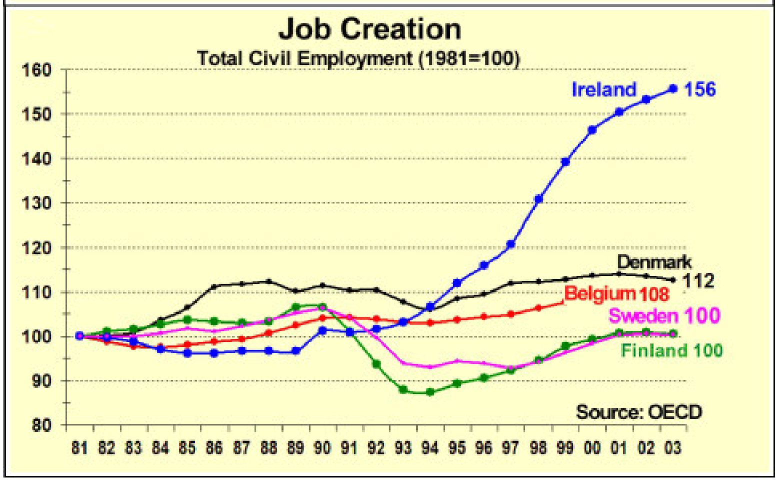
Belgium's was able to create 8% new jobs between 1981 and 2003, Sweden and Finland were unable to create any jobs at all in over two decades. Denmark did a little better because it "activated" its labour market by making it more "flexible." It became easier for employers to fire people. For workers in the construction industry the term of notice was reduced to five days.

Unemployment benefits were restricted in time, while those who had been unemployed for a long time, and young people could lose benefits if they refuse to accept jobs, including low-productivity jobs below their level of training or education. The result is that productivity growth in Denmark is lower than in Sweden and Finland.

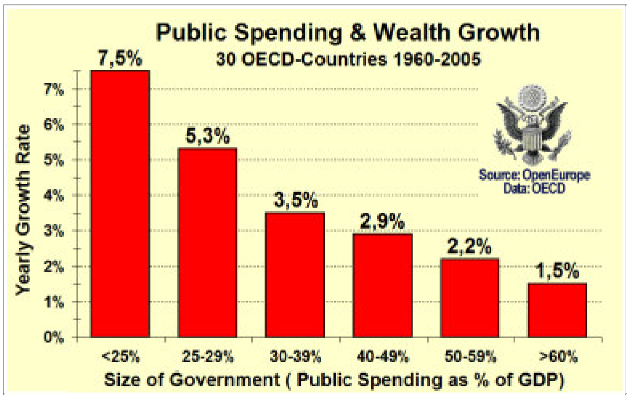
These draconian measures reduced the unemployment rate, but did not eliminate the cause of unemployment, namely the total lack of motivation on the part of employees and employers resulting from the extremely high taxation level.

Despite the painful measures, the growth of Danish productivity and prosperity has been substandard. Disappointment in Danish politicians is one of the reasons for the rise of the far right.





Big government, bad government



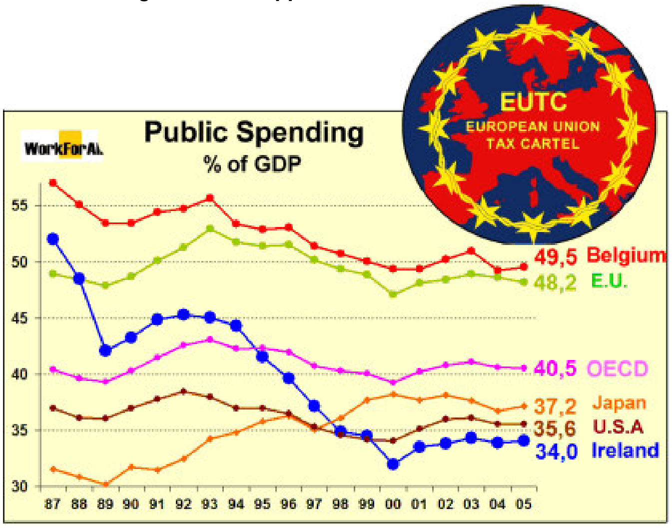
Why are the Scandinavian countries doing such a bad job, despite their Protestant work ethic and devotion to duty? The main cause is the essence of the nanny state: its very high tax level. Between 1990 and 2005 the average overall tax burden was 55% in Finland, 58% in Denmark and 61% in Sweden. This is almost one and a half times the OECD average.

In his research into the causes of growth differences between OECD economies the American economist James Gwartney showed that there was a direct correlation between economic growth and tax burden. The higher the level of taxation, the lower the growth rate.

The explanation for this phenomenon is as logical as it is simple. The higher the tax level, the lower the incentive for people to make a productive contribution to society. The higher the fiscal burden, the more resources flow from the productive sector to the ever more inefficient government apparatus.

Ireland: the efficient alternative

Ireland has proved that a substantial lowering of the taxation level can become the motor for launching even the most slackish economy into full gear. A drastic reduction of the Irish tax rate, from 53% in 1986 to its current 35% , has led to a continuous boom of wealth creation at an average rate of 5.6% during the past two decades, while the number of jobs has grown by over 50%. In barely 18 years Ireland jumped from the 22nd to the 4th place in the OECD prosperity ranking. Ireland did not reduce its social welfare benefits. On the contrary. The unprecedented growth led to an increase of fiscal revenue and social expenditure. It was sufficient to improve the productivity of the government.

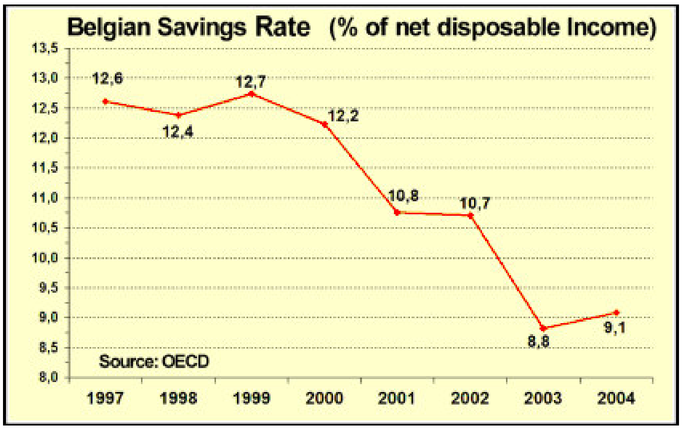


One crucial element of the Irish model is its "fair tax" system, in which there is less emphasis on taxing labour and profit and slightly more on taxing consumption. This balance between direct and indirect taxation motivates labourers and entrepreneurs to make productive contributions. It stimulates new initiatives and guarantees a high degree of participation. Such a fiscal system does not put the entire burden of financing social security on domestic production. Indeed, a consumption tax ensures that foreign production also contributes evenly.

The Irish model combines the so-called "active welfare state" of continental Europe with the Anglo-Saxon liberal economy in a balanced fashion. The model is efficient. Ireland surpasses all other EU members in prosperity, job creation, social expenditure and productivity per working hour.

Investing in the future

The difference between the wealth destructive Scandinavian model and the booming Irish alternative is obvious for all to see. Strangely enough, however, the French and German governments do not seem to notice. Those in Belgium do not, either. The Belgian government recently proposed a new policy plan inspired by the Danish model. The tax level is not reduced, the fiscal burden is not being shifted from production to consumption, but instead from one production factor (labour) to another (capital) which is already overburdened. Saving is discouraged, too. After deducting inflation and the witholding tax, which under the European savings taxation directive will soon amount to 35%, the real net interest rate will be –2%. This means that every person in his thirties who is saving 1.00 euro today, will only have the equivalent of 0.54 euro when he turns 60.

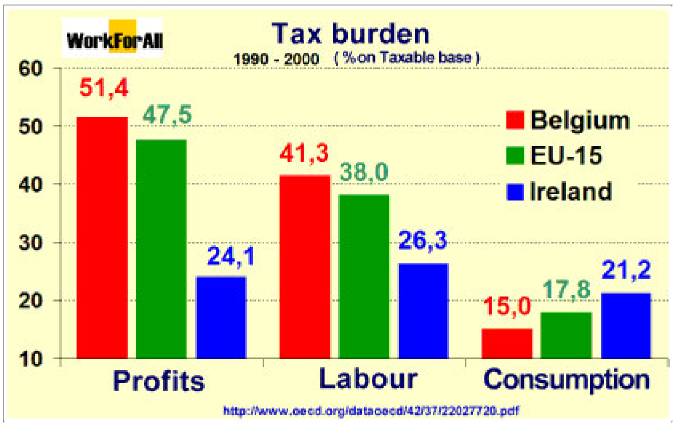


In barely six years the Belgian savings rate has already dropped by more than a quarter: from 12.4% in 1998 to 9.1% in 2004. The savings rate will drop even further, thereby drying up all reserves for investment. Like work, saving and investing, too, must be profitable if people are to engage in these activities.

Excessive taxation

2004 witnessed a record world economic growth of 5%. China and India are booming, the US and Japan are recovering. Gwartney's findings explain why continental West European countries, such as Belgium, did not see their economies grow. The Belgian tax burden is 9% higher than the OECD average and 15% higher than the tax level in the US and Japan. If continental Western Europe does not change its policies, its relative impoverishment today will soon turn into absolute pauperization.

Tax structure unadapted for globalization.



Its tax structure is not adapted to the challenges of globalization. Taxes on production are the opposite of import taxes. They double Europe's production costs and, in doing so, halve its productivity. Like protectionism they lead to distortions in world trade, but they do so in the opposite direction.

Ever more rapidly, continental Western Europe is losing its semi labour-intensive sectors to countries where productivity is even lower than in Western Europe. This move from high productivity to low productivity countries is a waste. It is not only a catastrophe for Western Europe's employment. It is also bad for the world at large because the highly productive production apparatus and infrastructure of Western Europe is not used to its full capacity. This leads to less than optimal global labour division and wealth creation. Politicians must realize that economic growth is not brought about by fiscally punishing productive citizens, nor by collective impoverishment and social welfare cuts, but by cutting taxes and bureaucracy. Ireland has shown that it can be done and how to do it.

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of the Flemish think tank Work for All.

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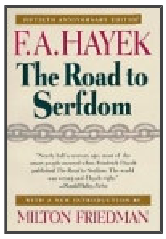

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The Road to Serfdom. This masterpiece of Nobel Prize laureate Friedrich Hayek is an eye-opener, strongly advocating the free market principles.

In this all-time classic Hayek persuasively warns against the authoritarian utopias of central planning and the welfare state. Fascism, communism and socialism share these utopias. For the implementation of their plans these authoritarian ideologies require government power over the individual, inevitably leading to a totalitarian state. Every step away from the free market toward planning reduces people's freedom and is a step toward tyranny.

Planning also cannot assess consumer preferences with sufficient accuracy to efficiently co-ordinate production. In a free markets however "Price" is the all-inclusive source of information, guiding entrepreneurs to produce whatever is wanted and directing workers wherever they are most needed. A free market also provides the entrepreneurial climate for a thriving economy and for releasing the creative energy of its citizens. Free individuals in their native strive to develop their talents and to improve their fate produce spontaneous progress.

All public interference in the economic process disturbs the market equilibrium, distorts the optimal allocation of resources and consequently reduces the level of wealth. Where planning replaces free markets people do not only loose their freedom and individuality. Slow growth also increases welfare demands leading to dependence similar to slavery. In the end people's self-reliance and self-respect is ruined, and citizens are degraded to a means to serve the ends of the collective mass.

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The Path To Sustainable Growth

Lessons From 20 Years Growth Differentials In Europe

Martin De Vlieghere and Paul Vreymans

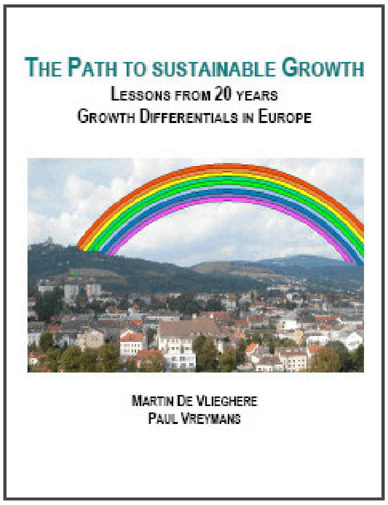
Abstract: While the rest of the world is booming, Europe lags behind. Europe's performance is weak in spite of high productivity and knowledge, high level of development and good labour ethics. Growth is also remarkably dissimular among regions. France, Germany and Italy are stagnating, and so do Denmark, Sweden and Finland. All gained less than *44%* prosperity over the last 20 years. The Irish economy grew 4 times faster, gaining *169%* wealth over the same period. In half a generation Ireland so metamorphosed into Europe's second richest country creating jobs for all.

" Big government " is the main cause of Europe's weak performance. The oversized Public Sector lacks productivity and is undoing the entire productivity gains of the Private Sector, eradicating all of its outstanding performance and productiveness. Europe could improve its overall performance by copying the Irish success formulas: Scaling down Public Spending, downsizing bureaucracy, and shifting the tax burden from income on consumption. This book demonstrates why the Lisbon Agenda and decades of Keynesian inflationist demand stimulation have failed. It devellops an alternative and workable supply-side strategy as well as effective cures for a humane and financially sustainable development.

This book reads as a step-by-step manual for economic recovery. It is a data-reference for students and politicians interested in growth, wellfare and in social modelling. It is a classic for economists concerned about Big Government, poor public sector productivity and for parents worrying about their declining standard of living and their children's future.

- Part 1 - The Economics of Taxation -
- Part 2 - The Causes of Growth Differentials - Multiple Regression Analysis
- Part 3 - A Case Study: Ireland versus Belgium
- Part 4 - Loosing Overweight: A Slimming Cure for big Governments.
- part 5 - Comparison With Other Studies

Find the Summary here



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