

The tortuous politics of sustainable welfare states

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It is an honour to comment on a lecture by one of the leading scholars on the economics of the Nordic welfare model. Torben Andersen provides a very instructive, pedagogical and useful overview of the economics of the Nordic welfare model. I will not waste space by summarizing his convincing arguments. Let me instead point to some political challenges that arise for Nordic decision-makers who want to take informed and well-meaning decisions on economic policy and welfare arrangements.

Torben's overview is a fine proof of the fact that the economics of Nordic welfare states has created a lot of scholarly interest for the Nordic model, among academic economists and economic commentators in general. This also reflects the generally high esteem of Nordic economic policies among liberally inclined economic commentators. This is by itself a remarkable fact. Many well trained economists are attracted to the idea that it is precisely the Nordics that have been able to combine the basic principles of free market economics with appropriate collective interventions that correct market failures and promote equitable outcomes. In my view, the Nordic model comes closest to the solution of the problem inspired by philosopher John Rawls: how should we arrange society if we want to optimize the welfare of a randomly chosen individual, from behind a veil of ignorance? This idea now seems to be shared by almost everyone, and particularly so among economists.

Torben shows that there are at least theoretically plausible solutions to many of the current challenges that seem to afflict Nordic welfare arrangements. In particular, the dreaded Baumol disease argument need not be fatal if productivity-enhancing technologies can also be applied to the production of welfare services and there is a political capacity to tax service users according to their preferences for welfare services. The latter condition may seem demanding but establishing differentiated user fees for some publicly subsidized welfare services seems a natural and politically plausible way of interpreting that theoretical conclusion.

However, let me just emphasize how demanding the politics of an optimal welfare state are. Torben's analysis gives absolutely ground for optimism, in the sense that there are policies that keep the welfare state financially viable. However, such policies must also be in the interest of representative and likely political coalitions. In general, from the point of view of a political decision-maker like me, good policies

that keep the Nordic welfare state sustainable are quite demanding and presuppose extremely responsible policymaking. I am not saying that they are impossible, but they are definitively wrought with dangers.

Before going into some specific policy areas and issues, let me just make a historical observation that must condition an argument like this. The Nordic welfare model as it exists now can very well be interpreted as a result of how an enlightened neoclassical economist would want to organize society. He/she would integrate the domestic economy into the international division of labour in order to maximize average economic well-being. At the same time, he/she would create social insurance mechanisms that share risks, so that the fruits of being part of global capitalism would be shared in a reasonably equitable way. And, finally, he/she would tax the citizens and create publicly provided services like basic education and health that would not be optimally forthcoming in a private market.

So far so good. But my very simple point is that the original political motivation of the Nordic welfare state was not identical to the thought process of an enlightened neoclassical economist. Instead, the welfare state was created in an arduous political process which its main protagonist – Social Democracy – often interpreted as a “struggle” to mete out better working conditions and other advantages from the capital owners. It also involved a long political discussion about the proper way of organizing ownership and production. This latter debate has now probably been resolved in favour of a liberal market order based on private property. It is also a remarkable fact that Social Democracy has been dethroned from its dominant position in Nordic politics. It seems to me that the Nordic centre-right parties, having accepted the basic ideas of the welfare state, have now become quite reliable guardians of this great Social Democratic achievement. At the same time, Social Democracy seems quite ill at ease with some of the demands of current economic orthodoxies.

So, the welfare state can surely be motivated out of common good. But common good does not automatically translate into viable political majorities, in particular if the economic policies that now in the eyes of technocrats seem adequate are rejected and resented by large swaths of the electorate.

Labour supply and the political difficulty of incentivizing ourselves

The big challenge of modern welfare states is to sustain high enough employment rates. This is an in-built problem of the Nordic model. We want to guarantee a decent income

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and welfare standard even for people who do not currently work. This implies that the price of leisure in term of foregone consumption (of private and publicly provided goods and services) becomes “too” low, and the choice of working hours must be manipulated upwards by other means. This is done, of course, and quite effectively, too, by subsidizing services complementary with working hours (such as childcare) and imposing minimum retiring ages as well as stringent labour market policies that condition transfers on labour market availability.

Still, this is and continues to be a politically difficult issue. It was not an immediate constraint in the time of “demographic tailwinds”, to use Torben’s expression. Yet now, as the growth of working age population stalls and the dependency ratio worsens, a need for sharper work incentives arises. This is exactly what has happened – an “activation turn” towards more stringent labour market policies has taken place in all the Nordic countries.¹ Unemployment insurance systems have become less generous and more conditional on the individual’s good behaviour in the labour market. Yet this issue remains politically difficult and is probably one factor that has contributed to the rise of populist political parties. It is also likely to weaken the very solidarity that originally motivated the creation of unemployment insurance systems. The idea that “we”, the people, must create sufficiently sharp work incentives for ourselves, in order to prevent anybody from exploiting the system, is perfectly rational but not at ease with the original ethics and politics of the Nordic welfare state. Rational employment policies must, as it were, treat every citizen as a potential free-rider, and this does not accord well with the ethics of the worker’s movement that created these social insurance institutions in the first place. In my view, this “activation turn” is probably one reason for the ascent of populist right wing parties.

Nationalism or universalism in an aging society

Another, related issue is the opposition of nationalism and universalism in Nordic politics. The same demographic headwind that has accentuated the need for stringent employment policies has also created a demand for major work-related immigration. As the number of indigenous working age people grows more slowly than before or shrinks altogether, a large flow of immigrants in search for work has become an important source of employment growth and thereby, of public sector sustainability. For example, about half of the employment growth in Sweden of the recent years (during this decade) is due to growth in employment among the foreign-born; in Norway, this share has recently even exceeded 50 percent. Finland has traditionally had a lower immigration flow, but it is clear even in this country that some sectors and areas are quite dependent on work-based migration.

Immigration of young, working age people benefits these countries’ public finances provided the employment rates of immigrants are high enough, and provided our school sys-

tems succeed in educating the immigrants’ children so that they will become employed with a high enough probability. Thus, increased immigration, if successful, is clearly one way of keeping the Nordic welfare model economically sustainable.

Yet even here, there arises a political controversy about the proper “owners” of the welfare state. We economists are trained to treat all people as identical, nationless economic agents. In a time of increasing international mobility, it is clear that the Nordic welfare state should be designed as being neutral to nationality. It should be able to balance its books even if its workforce is mobile and large inflows and outflows of people do take place. This should not be too difficult in principle. Social insurance systems and education and health services should be designed in such a way that entitlements only become operative after an incoming individual has made some contributions in the form of taxes and insurance payments. By the same token, the services and transfer streams provided for outward migrants should be appropriately limited. However, for some voters, the very idea of a Nordic welfare state is not at all a social contract between anonymous agents, regardless of origin. Again, this is very clear in the politics of the populist right. They tend to think that indigenous Swedes, Finns and the like should effectively enjoy better transfers and other entitlements than incoming migrants. For them, the welfare state is for “us”, not for everybody or any abstract identity.

Is there a political glue in the liberal economic order?

Thus, I suspect that the necessary labour market policies as well as the necessary immigration lead to a political reaction in the form of a welfare-chauvinistic populist Right that threatens the rational economic policies that are called for. Let us hope that this political reaction will not lead to costly policy reversals. But on a more abstract level, the issue is whether a Nordic welfare state is politically sustainable. Its economic policy must be based on a finely balanced combination of liberal economics and collective interventions. Will such a liberal economic order even in the future produce and reproduce the necessary political and social “glue”, the social capital that ties people together and creates enough trust and solidarity to sustain responsible economic policies? Even more than the conventional budget constraint, this political issue will determine the viability of the Nordic model.

References

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¹ We have described these policy reforms in a recent chapter by Dølvik, Andersen and Vartiainen (2014).