

Welfare State or Unfair State?

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Dominique de Villepin, France's Prime Minister, talks about "economic patriotism" and has launched a number of protectionist policies. Barriers to global trade, subsidies to agriculture and industry, and stopping foreigners from investing in French companies are just a few examples. A country that recently had riots because of its economic and social failure now wants more of the same policies.

German Finance Minister Peer Steinbrück has urged the new EU member states to raise taxes, since their currently low rates have "nothing to do with fair tax competition", he says. Steinbrück obviously wants to force new EU members to get rid of one of the main reasons for their success. Instead of lifting Germany up, he wants to drag others down. Would he be happier if all European countries had the growth and unemployment levels of Germany?

The European Parliament has approved a worthless and watered-down Services Directive. By removing healthcare and education from the scope of the directive MEPs have removed the sectors that would have benefited most from free trade in services. They have also removed the important and simplifying 'country of origin' principle. The gains could have been enormous: independent studies pointed to 600 000 new jobs. Some 70 per cent of EU GDP already comes from services.

These are only three examples of how the spectre of protectionism is haunting Western Europe more today than for a long time. Indeed most of Western Europe is in economic trouble. But if there are problems, isn't the most logical consequence to see what we are doing wrong and change it? If you can't compete well, then why not become more competitive instead of trying to shut out the world or forcing others to become less competitive?

The Model is the problem

Never before have so many countries been as successful as today. Economic growth is strong in many countries and poverty is decreasing faster than ever. People are living longer and healthier. A global market economy is spreading opportunities for a better future. But most of Western Europe is in economic trouble and faces a choice: market-oriented reforms that decrease the size of the state, or keeping the current model, and attempting to "protect it" by shutting out the world.

Nobody denies that the problems are real, but governments have a tendency to fob off voters with assurances that neighbouring countries are even worse off. Economic growth is low, unemployment is high, dependency on the state is increasing and welfare services are deteriorating. These problems in many Western European countries are obvious. Still, most politicians don't want radical reform; they want to keep the European Social Model.

Let's be clear: the so-called 'social model' is all about having a very big state financed by high taxes, and that model creates the current problems. The evidence for this is overwhelming. The state takes care of large parts of people's lives – especially concerning social matters such as social security and welfare services – with their own money. It is sometimes called the welfare state, but it is really an unfair state.

There are differences between the Western European countries, but there are clear main features of the European Social Model. The tax burden is very high and rose from about 20% in 1950 to between 40 and 50% in 1980 – where it finally stopped. Governments finance and provide - one way or another - welfare services such as education, health care, child and elderly care. In various forms, the model also contains social security systems: public pensions and income transfers for unemployment, sick leave, early retirement, etc. The labour market also tends to be highly regulated or arranged in a corporatist way.

Low growth, unemployment, dependency on the state

First of all, a big state financed by high taxes definitely brings low – or negative – economic growth. Western Europe has clearly lagged behind mainly the US since the emergence of the big state in the 1970s. The famous aim of the EU's Lisbon process in 2000 was to close the wealth gap with the US by 2010. Since then, the gap has widened further. In fact, in 38 American states the average person is richer than the average person in any country in Europe, except Luxembourg. And the average American is about 40 % richer than the average European.

Second, high taxes on work indirectly punish workers and make hiring more expensive. And by giving these taxes to the increasing amount of people who are not working, the unemployed are rewarded. In many Western European countries, the economic difference between working and living off the state is very small. In this way the Model leads to fewer people working and more people being supported by those who are working. Between 1970 and 2003, employment in the US rose by 58.9 million, which is equivalent to a 75% increase. In France, Germany and Italy combined it rose by 17.6 million people, or 26%.

Third, a highly regulated labour market protects existing jobs and stops new ones from emerging. This is a direct consequence of the Model, since its very purpose is to

prevent people losing their jobs. Those who do have jobs are protected, but afraid of losing their job, and those who don't have jobs, are kept out of the labour market. The more regulated the labour market, the fewer new jobs there are. This effect was particularly clear in Denmark, which has de-regulated its labour market in recent years and has subsequently experienced very good development.

Fourth, monopolies cannot deliver either goods or services efficiently, on time, with good quality or at a good price. And in most of Western Europe, social security and welfare services are public monopolies. The Swedish Association of Local Authorities and Regions reports that doctors see an average of four patients a day, down from nine in 1975. The number of hospital beds is down by 80 percent since 1975. More than 50 percent of patients have to wait over 12 weeks for an examination and then at least 12 more weeks for treatment.

Some EU leaders seem to look to the Nordic countries for inspiration. In some respects that may be a good idea – there have certainly been a few reforms in recent years. But these countries are still clinging on to an extreme version of the big state, which is still creating the same problems as those apparent in the rest of Western Europe. In Sweden, youth unemployment is the sixth highest in the EU, and the total (partly hidden) unemployment rate is about 20%. Growth during the last 15 years has been 1.4% on average, lower than the US, EU and OECD average.

Direct consequences of the Model

The state was supposed to provide welfare services and social security. But in the public sphere, private companies, private property, free competition, free financing, interest in profit are all prohibited, which explains much of why it is going wrong. These are the forces of growth, and if you prohibit them, you prohibit growth.

Imagine prohibiting these forces in other fields: would we have such a range of mobile phones to choose from if there was only one state telephone monopoly? Or take a more fundamental need - food. What kinds of food and drink would we have if it weren't produced and delivered by private companies? We would have queues of people waiting for bread, most likely, as we do have now in health care.

This model of big government is largely based on the assumption that there are resources just waiting to be shared by everyone. There is a big cake which government can just distribute to people. That is a fundamentally false assumption. All resources have to be created; nothing – not cars, nor hospitals, nor food, nor heating for your house – is just there in nature for the taking. Thus, we have to create a society with the best opportunities for the forces that create the resources. The European Social Model does, to a large extent, the opposite.

A new dawn

The problems shared by most Western European countries are serious and the Model itself is causing them. The defenders of the Model claim they like it because it is all about solidarity and social justice. Reality suggests the opposite; it is a truly unfair Model. Those on low incomes pay very high taxes and become dependent on the state – that can't be solidarity. Elderly people do not receive good care from monopolies – that is not social. Young people never get a job despite a good education – that is destructive.

These problems will get worse unless there are reforms. The globalised economy means opportunities for more people than ever, and increases competition for production and jobs more than ever before. We simply have to be competitive. The demographic situation, whereby we live longer – a great success – implies that we should change our out-dated systems to stop public expenditure from exploding.

We need to reform today - the sooner the better. If we actually reform, Western Europe could face a new dawn and start on the road to prosperity, with more jobs, increased growth and better living standards. We could have a society that gives young people hope and elderly people a good life. Since the size of the state is the problem – i.e. its interference with taxes and regulations – the emphasis of reform should be on decreasing that size.

Other countries have done it with great success. Not only Eastern and Central Europe, but also New Zealand, Australia, Iceland, the US and many other countries. There have even been a few good examples of reform in Western Europe, but more is needed. The state should use its resources to help those in need, not to run everyone's lives. If reforms decrease the size of the state, the forces that create resources – entrepreneurs and working people – will be freer.

Reform works

There is recent new empirical evidence that this kind of reform works:

Employment growth has been high in several of the 'old' 15 EU member countries, notably Ireland, Spain and the Netherlands. But employment has grown very poorly in many countries, worst of all in Germany. Sweden, sometimes regarded as a positive example, had the fourth poorest employment growth. Employment grew by 18.5% on average in the five countries with the best growth, and by only 3.5% in the five poorest ones. The question is: what differences are there in policies that can directly affect employment?

There are naturally many reasons behind the different growth rates, but there are clear connections with the degree of market-oriented reform. According to the OECD the total tax on employment in the five countries with the best growth was

30.5% and in the countries with the worst growth it was 41%. In Ireland, with the best growth, the tax on work was 15.5% and in Germany, with the very worst, it was 45.5%.

Looking at the degree of regulation on the labour market, the pattern is also quite clear. The Economic Freedom of the World Annual Report for 2005 from the Fraser Institute contains a scale between 1 and 7 with 1 being the most regulated and 7 the freest labour market. The average for the five countries with the best growth was 5.06 and for the five with the worst growth it was 3.64. For Ireland, again, the figure was 5.4 and for Germany, it was 2.8.

The levels of contributions from the state to unemployed people and those on sick leave are lower in the countries with good employment growth. On average, they are ten percentage points lower in the countries in the top half than in the countries in the lower half. Naturally, this makes it easier to also keep lower taxes on work.

If the differences do not seem dramatic, this shows that limited reform might have substantial results. But of course, if you combine them all, the results will multiply. Several conclusions can be drawn from these facts. One is that it is indeed possible for “Old Europe” to be successful too in terms of employment. Another is that the determinants of growth are not beyond control. Instead, any country can adopt the policies that have obviously been successful in several countries: low taxes on work, a free labour market and low contributions from the state.

Conclusion

It is essential to avoid attempts to keep the anti-social Model intact by pursuing protectionist policies. We need to do the opposite and embrace reform. There may well be obstacles: many people are dependent on the system and don't want change, many taxes are hidden so people can't see the full extent of the state, and politicians find it hard to reverse their old policies. But still we must reform for the future to be bright.

Clearly everything cannot be done at once. Reform must take place on a step by step basis. If initial reforms are carried out and lead to positive results, there will be more support for further reform. That way, a country can start off a positive development with more reforms and more improvements: a positive circle instead of the vicious one we have today.

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