

**THE SWEDISH LESSON: THE WELFARE STATE DESTROYS ITSELF**

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**Abstract**

Following the collapse of the Soviet Union, there has been an increased interest in the welfare state, with many claiming it to be a viable alternative to free-market capitalism. The Swedish welfare state, in particular, has been subject to much praise. However, a closer look show that it produces moral hazard, which over time diminish the sense of individual responsibility. Due to this, the welfare state carries the seed to its own destruction, as it undermines the very norms that it relies on. As these negative aspects have become more apparent, there has been a move to reduce generosity of the Swedish welfare state. Yet, this has not managed to alleviate the many problems that face it.

**Keywords:** Moral hazard; Welfare State; Swedish economic history; Protestant ethics; Social democracy.

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### *La lección sueca: El Estado de Bienestar se destruye a sí mismo*

#### Resumen

Tras el colapso de la Unión Soviética, se ha generado un creciente interés en el Estado de Bienestar, sobre el cual muchos afirman que es una alternativa viable al capitalismo de libre mercado. El Estado de Bienestar sueco, en particular, ha sido objeto de muchos elogios. Sin embargo, al mirarlo más de cerca, encontramos que produce una condición de riesgo moral, que con el tiempo disminuye el sentido de responsabilidad individual. Debido a esto, el Estado de Bienestar lleva la semilla de su propia destrucción, ya que vulnera las propias normas de su existencia. A medida que estos aspectos negativos se vuelven más evidentes, se ha producido un movimiento para reducir significativamente la generosidad del Estado de Bienestar sueco. No obstante, esto no ha logrado aliviar los muchos problemas que enfrenta.

**Palabras clave:** Riesgo moral; Estado de Bienestar; Historia económica sueca; Ética protestante; Socialdemocracia.

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## 1. Introduction

Today, few people favor total government control over the economy and society. This mode of organizing society has failed to deliver on its supporters' promise of prosperity everywhere it has been introduced. On the contrary, it has caused misery in countries such as The Soviet Union, Cuba, Venezuela, and North Korea, among others. And even in a country like China, which declares itself to be socialist, its economic progress has rather followed from free-market reforms<sup>1</sup>. This failure of hard-line socialism has provided the foundation for increased support for a less radical form of it: social democracy. Unlike socialism, social democracy does not seek to abolish the democratic system nor seize the means of production. Instead, it allows both for political and economic competition. It favors government control of some parts of the economy, but not all. Services such as education, health care, and elderly care are to be provided through public monopolies, funded by tax money.

Even in the US, which for decades has been unconvinced by socialist ideology, social democracy is on the rise. Its main ideologues, such as Bernie Sanders, view the Nordic countries as role models. This has been a recurring theme in the debates of the 2020 Democratic Party presidential primaries, but even as early as 2015 Sanders explained: "I think we should look to countries like Denmark, like Sweden and Norway and learn from what they have accomplished for their working people" (CNSNews). While democratic socialism is struggling at large in Europe, it is common for socialists to point to the Nordic countries. They are said to represent the success of socialism in action. And so, the Nordic countries are the last true role model of international socialists.

The idea of the Nordic nations proving the success of socialism is an old idea put forward by the intellectual left. At first glance, these countries seemingly have everything that the left strive for: prosperity, but also equality. However, what is missed is that these welfare-states have an end-date, as they undermine the specific values that they are dependent on.

## 2. The risk for moral hazard in the welfare state

The welfare state is often compared to an insurance institution, for example visible in the term "social insurance"<sup>2</sup>. Like an insurance, the insured provide part of the funds regularly (through taxation) and then claim benefits if a specific event were to occur.

One fundamental difference, however, separates an insurance company from the welfare state. Unlike the welfare state, an insurance company will mainly offer insurances for events which the insured have no or little control over. They will provide the money that is required for the insured to rebuild his house if it falls victim to a forest fire, but they will not cover the expenses if he were put his own house on fire. The reason for this is that it would risk creating

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<sup>1</sup> See: Li, S., Li, S. & Zhang, W. (2000). *The road to capitalism: competition and institutional change in China*. Journal of Comparative Economics, vol. 28: 269-292.

<sup>2</sup> Cf. Also Barr (2012) p. 9, which names insurance as one of the three key purposes of the welfare state.

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moral hazard, meaning that people would act with disregard of the consequences as they do not fall on them. If there is a smoker that requests a health insurance, what normally happens is that he has to pay a higher premium or is outright refused an insurance.

The nature of the welfare state is quite different. It commonly pays benefits to people who have some control over the events in question. While it is true that people do not control events such as unemployment fully, they at least have some ability to influence them. And it uses no of the techniques that the insurance company does, which charges higher premium to people taking higher risks or refusing them, but instead follows the principle of universality with universal coverage<sup>3</sup>, it is possible for people to bring about these events themselves and then receive benefits for it. However, this does not need to become a moral hazard, defined as people acting without care for the consequences. Strong norms may restrain people and induce people to pay regard to the consequences, even if they are not personally responsible for them.

At the start of the 20<sup>th</sup> century, the Swedish people had such norms. The protestant ethic of honesty and hard work was deeply imbued in the Swedish spirit<sup>4</sup>. The ethic was succinctly captured in a quote often attributed to American railway entrepreneur James J. Hill: “Give me snuff, whiskey and Swedes, and I will build a railroad to hell”.

### 3. How the welfare state undermines the values it depends on

If we reflect further on this state, some questions regarding its sustainability arises. We may for example consider the phenoenon of group psychology. According to researchers Ernst Fehr and Urs Fischbacher, legal rules and legal enforcement mechanisms typically lack effectiveness if not backed up by social norms. That is to say, we follow the rules when most of us think they make sense. In free societies, governments don't have the power of enforcing rules that fundamentally disagree with the beliefs of the people. Social norms can in this sense be seen as rules of “conditional cooperation.” Critically, defection of others proves to be a legitimate excuse for individual defection (Fehr & Fischbacher, 2004). In other words, if an individual perceives that her neighbors stick to the norm, she will be likely to do the same. If the neighbor is dodging his taxes or cheating the system to get money from the government, however, the individual's own tendency to follow the rules will be diminished. If your neighbor works less, your own drive to work might be impeded.

The thing with norms is that they change slowly, over the course of generations. When the government raises taxes or makes living on benefits more advantageous, most people continue to act as they have done previously. But this does not mean that norms are set in

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<sup>3</sup> As described by Kildal N. & Kuhnle, S. (2005). Normative Foundations of the Welfare State: The Nordic Experience. Abingdon-on-Thames: Routledge.

<sup>4</sup> As late as the 1960's, a petition opposing the change of the school subject name from “Christianity studies” to “Religion studies” amassed 2,1 million signatures, constituting approximately 30% of the population at the time, Svensson, 2012. This shows how deeply religious Swedes at the time were, making it clear that Protestant ethics were influential in Sweden.

stone. Over time even the Swedish people have changed their attitudes as social democratic policies have made it less rewarding to work hard and more rewarding to live off the government. When people see a behavior being rewarded, it starts to become more accepted. This is in accordance with research by French economist Jean-Baptiste Michau. He has suggested that a link exists between government benefits and cultural transmissions of work ethics. Michau (2009) explains that parents make rational choices regarding “how much effort to exert to raise their children to work hard” (p. 2), based on their “expectations on the policy that will be implemented by the next generation” (Ibid). Therefore, changes in culture happen over time as families react to new policies. Once Michau (2009) takes into account that changes occur slowly, he can show that large unemployment insurance benefits can explain much of the changes in unemployment levels in Europe that have occurred over time. This undermining effect is clearly visible in Sweden. In the beginning of the 1980s, 82 percent of Swedes agreed with the statement “Claiming government benefits to which you are not entitled is never justifiable” (p. 29). However, as the population adjusted their behavior to new economic policies, benefit morale dropped steadily. In the survey conducted between 2005 and 2008, only 61 percent of Swedes believed that it was never right to claim benefits to which they were not entitled. The World Value Survey conducted between 2010 and 2014 showed that benefit morale had continued to fall, as merely 55 percent of Swedes answered that it was never right to overuse benefits.

This would not have been a surprise to the American president Franklin D. Roosevelt, who was the architect of the American welfare state. He understood that large scale welfare hand-outs could endanger society and cause moral corruption. With foresight he explained in (1935):

The lessons of history, confirmed by the evidence immediately before me, show conclusively that continued dependence upon relief induces a spiritual and moral disintegration fundamentally destructive to the national fibre. To dole out relief in this way is to administer a narcotic, a subtle destroyer of the human spirit. It is inimical to the dictates of sound policy. It is in violation of the traditions of America.

Going back in time, the views of Roosevelt were anything but uncommon. At the beginning of the 20<sup>th</sup> century, even the proponents of the welfare state worried that the expansion of welfare programs would endanger the social fabric. To understand this reasoning, one must know that for the welfare state to function properly, it is not enough that most individuals follow the norm of properly paying their taxes. Neither does it suffice that most individuals follow the norm of not overutilizing welfare services. Rather, for the system to be viable in the long-term, the vast majority of individuals must abide by the social contract.

The German scholar Friedrich Heinemann (2008) has set about to examine Roosevelt’s claim “of the moral disintegration effect of welfare dependency” (p. 257). By looking at the World Value Survey, a global survey of attitudes conducted since the early 1980s, Heinemann has concluded that a self-destructive mechanism exists in a welfare state. When welfare benefits becomes larger, and when unemployment reaches high levels, people find it more acceptable

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to take advantage of welfare programs: “In the long-run an increase of government benefits and unemployment is associated with deteriorating welfare state ethics” (Ibid). The behavior that we would expect, based on our earlier reasoning, has empirical backing. If government handouts increase in size, more people will seek them. Particularly when jobs are scarce, welfare dependency becomes a real concern.

The problem of moral hazard problem quickly became evident as the American welfare state grew. As Ronald Reagan explained during a radio address in 1986, it was quite evident that welfare dependency was a genuine concern. Reagan, who was serving his second term as president, said:

From the 1950s on, poverty in America was declining. American society, an opportunity society, was doing its wonders. Economic growth was providing a ladder for millions to climb up out of poverty and into prosperity. In 1964 the famous War on Poverty was declared and a funny thing happened. Poverty, as measured by dependency, stopped shrinking and then actually began to grow worse. I guess you could say, poverty won the war. Poverty won in part because instead of helping the poor, government programs ruptured the bonds holding poor families together.

The detrimental moral effects of a large welfare state were more readily observable in the US – but were gradually also felt in Sweden, whose strong protestant working and responsibility norms eroded over the generations as people adopted to generous welfare and high tax policies.

Support for the claim of a self-destructive mechanism in the welfare state can also be found in the work of other researchers. A study by Martin Halla, Mario Lackner, and Friedrich G. Schneider (2010) performed an empirical analysis of the dynamics of the welfare state. They concluded that individuals do not respond to changes in economic incentives right away, because people are constrained by social norms for some time, and “therefore, the disincentive effects may materialize only with considerable time lags” (p. 2) This is to say, if your parents teach you to never live off welfare benefits if not forced to, you are likely to follow this norm even if the benefits become larger.

When the generosity of the system increases, however, parents become less likely to teach this norm to their children. The shift in behavior thus takes some time to occur. The authors found that in the short term, increased government spending on welfare programs can even have a small positive influence on benefit morale. As the welfare state is expanded, at least some people seem to make a concerted effort in not overusing it. Perhaps some even convince their neighbors to do the same. However, after some time the expansion of welfare programs leads to a deterioration of benefit morale. The three researchers concluded (2010) that “the welfare state destroys its own (economic) foundation” and that they “have to approve the hypothesis of the self-destructive welfare state” (p. 14).

This theory has been developed further by the Swedish economist Assar Lindbeck (1995, 2008). According to him, changes in work ethics are related to a rising dependence on welfare

state institutions. Additionally, he points out that the evidence of explicit benefit fraud in Sweden leads to a weakening of norms against overusing various benefit systems. According to Lindbeck, reforms to limit fraud are therefore quite important for maintaining a welfare state<sup>5</sup>.

A number of attitude studies in Sweden reach the same conclusion: a significant portion of the population has come to consider it acceptable to live off sickness benefits without actually being sick. A survey from 2002, for example, showed that four out of ten Swedish employees believed it was acceptable for those who were not sick but who felt stressed at work to claim sickness benefit. Additionally, almost half of those surveyed answered that it was acceptable for employees to claim sickness benefits if they were dissatisfied with their working environments or had problems within their families (Modig & Broberg, 2002). Other Swedish studies have pointed to increases in sickness absence during sports events. For instance, absence due to sickness increased by almost 7 percent among men at the time of the Winter Olympics in 1988, and by 16 percent in connection with TV broadcasts of the World Championship in cross-country skiing in 1987.<sup>6</sup> During the 2002 soccer World Cup, the increase in sickness absence among men was an astonishing 41 percent. The stark difference between the events during the end of the 1980s and the beginning of the 2000s might be seen as an indication of the deterioration of work ethics over time, during a period when the population became adjusted to large sick-leave entitlements (Persson, 2005).<sup>7</sup>

#### 4. The challenge of reform

To reverse this development, it is not enough to implement stricter enforcement of rules. Government measures to control how much public programs are used might signal to law-abiding citizens that violations have become a common practice. Heinemann has studied how generous welfare systems, meaning systems with big hand-outs, over time can undermine the very same norms that make the welfare systems possible to uphold. Heinemann (2008) explains that government sanctions can “be perceived as limiting citizens’ self-determination and will then further crowd out the intrinsic motivation to respect the law” (p. 240). This means that if society reaches a point where overutilization of welfare programs becomes common practice, the deterioration of norms might prove difficult to stop. Politicians cannot simply repair the social fabric through public dictates. In this light, one can better understand how Roosevelt himself viewed doling out relief as “a narcotic, a subtle destroyer of the

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<sup>5</sup> It is worth noting that Nordic countries have relatively large shadow economies compared to countries such as the United States. Scandinavian shadow economies have reduced as a share of total GDP over time, coinciding with a shift towards greater economic freedom. See: Schneider, F. & C.C. Williams (2013). *The Shadow Economy*. London: Institute of Economic Affairs.

<sup>6</sup> See: Skogman Thoursie, P. (2004). *Reporting sick: are sporting events contagious?* Journal of Applied Econometrics no. 19. 809–23.

<sup>7</sup> In this study, as well as Skogman Thoursie (2004), the sickness rate among women is used as a control for other variations.

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human spirit.” While the president actively expanded the American welfare state, he wanted to point out that there were legitimate reasons for concern about welfare dependency.

This claim by Heinemann seems to hold true in the case of Sweden aswell. During recent years, governments on both the right and the left in Sweden have reduced the generosity of the welfare system. Strict controls have been introduced in the sick leave system and other welfare programs. A recent paper suggests that the reforms may need to be even more far reaching to reverse the long-term effect that the welfare state has had on people’s behaviors. Economist Martin Ljunge (2013) has written:

Younger generations use sickness insurance more often than older generations. Amongst the younger generation twenty percentage points more take a sick leave day compared with those born twenty years before, after other circumstances have been adjusted for. The higher demand for sick leave pay amongst the younger generations can be seen as a measure of how rapidly the welfare state affects attitudes towards the use of public benefits. (p. 56. Translated from Swedish).

Generous welfare programs can have a long-lasting effect on people’s behavior by encouraging overreliance on public support. Even many years after public benefits have been changed, people’s norms still keep changing as they become adjusted to generous welfare.

It should also be added that there has been a harmonization affecting the welfare state, as described by Arthur Gould, following Sweden’s entry into the EU in the 1990’s. According to Gould (1999), the effect of this has been “partly quantitative (cuts and charges) and partly qualitative (sharpening of eligibility rules, some privatization)” (pp. 171-172), but he also notes that the size of this effect has been quite small. As this happened before Ljunge’s study and the increase in sickness statistics that we discussed above, it has not been enough to stop the development.

There is also other recent news that suggest that the policy shift of recent years might be too late. Swedish national radio reports that during 2018 almost a thousand alarms were sent to the Swedish Social Insurance Agency about erroneous transactions, amongst others for wrongful identities being used to claim benefits (Sveriges Radio, 2019). Tobias Wijk, an expert at the tax authority, explains that one form of cheating is to bring poor immigrants from other European Union members to Sweden. The person is registered in Sweden with papers for a false job and is then enrolled in the welfare system. Various government authorities have been tasked by the Swedish government to tackle the problematic development of benefit-cheating, yet cheating is expected to continue rise this year compared to last year.

Personal assistant for handicapped individuals has become a prosperous market for criminal groups. Between 3 to 6 percent of the funds paid out in individual assistance is estimated by the government to be paid out to cheaters (Sveriges Radio, 2018). This problem is far from new. In 2005 a delegation against wrongful payments in the Swedish welfare system was launched by the government. It found that fully 4 percent of the payments were unfounded,

either by mistake or to those who intentionally cheated the system. A follow-up inquiry found that in 2009, between 0.9 to 5.8 percent of total public benefits paid out were unfounded (SOU, 2017). Besides cheating, there is a greater problem of a welfare-trap, in which individuals who would otherwise be independent become dependent on various public handouts.

International admirers of the Swedish welfare state, who wish to import the model, should be aware of the problems of welfare dependency and outright cheating in this welfare model. Gradually over time, Sweden has moved towards significant reductions in welfare state generosity, yet the problems with cheating seem to have increased as criminal actors have zoned in on the welfare system. This is one of many reasons for why, the Swedish welfare system has severe problems with long-term sustainability (Sanandaji & Sahlgren, 2018).

### **5. The true Nordic lesson is about the limits of welfare**

Throughout its recent history, Sweden has been a country that prospers due to free enterprise policies. Currently, Sweden scores nearly as high as the US in The Index of Economic Freedom, since it compensates for high taxes and a generous welfare state by free-market policies in many other areas. The country has a strong tech-sector and is an important European start-up hub. But while the private sector is strong, the welfare state is in trouble (Heritage Foundation, 2019).

There is currently no lack of societal problems in Sweden, ranging from stagnating growth to an escalation of the form of violent crime (Konjunkturinstitutet, 2019), with the number of explosive materials investigated by the Swedish increasing twofold between 2014 and 2017 (Nationellt Forensiskt, 2017). The universal health care system continues to be plagued by long waiting times - an expected feature of a socialist model. A new inquiry, for example, finds that not a single region of Sweden manages to keep the promise that prostate cancer patients should be operated within two months after cancer has been discovered (Dagens Medicin, 2019). Many other similar reports have come in lately, showing the gaps in what was previously believed to be a superior health care system, but has over time evolved severe issues with accessibility. Initially, the architects of the Swedish welfare state believed that free health care could be offered, and that individual responsibility norms would lead to people seeking aid only when in need of it. As with other welfare state institutions, this mechanism failed over time as norms changed and increased the pressure put on the system.

Socialists have for decades pointed to Sweden as a proof that the welfare state can work and bring prosperity. Yet the social democratic model has not achieved its goal, due to itself undermining the values it requires for its success. For Sweden to revive the spirit that was the foundation for its industrialism, it must seriously question the welfare state. If this is not done, the problems now facing the welfare state will grow even more massive, as they are themselves spawned by the welfare state.

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