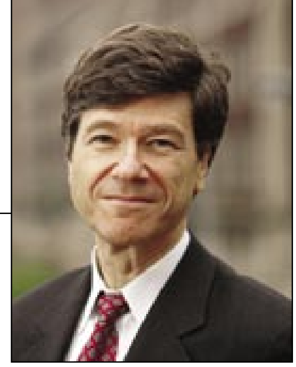

Welfare States, beyond Ideology

Are higher taxes and strong social "safety nets" antagonistic to a prosperous market economy? The evidence is now in By JEFFREY D. SACHS

One of the great challenges of sustainable development is to combine society's desires for economic prosperity and social security. For decades economists and politicians have debated how to reconcile the undoubted power of markets with the reassuring protections of social insurance. America's supply-siders claim that the best way to achieve well-being for America's poor is by spurring rapid economic growth and that the higher taxes needed to fund high levels of social insurance would cripple prosperity. Austrian-born free-market economist Friedrich August von Hayek suggested in the 1940s that high taxation would be a "road to serfdom," a threat to freedom itself.

Most of the debate in the U.S. is clouded by vested interests and by ideology. Yet there is by now a rich empirical record to judge these issues scientifically. The evidence may be found by comparing a group of relatively free-market economies that have low to moderate rates of taxation and social outlays with a group of social-welfare states that have high rates of taxation and social outlays.

Not coincidentally, the low-tax, high-income countries are mostly English-speaking ones that share a direct historical lineage with 19th-century Britain and its theories of economic laissez-faire. These countries include Australia, Canada, Ireland, New Zealand, the U.K. and the U.S. The high-tax, high-income states are the Nordic social democracies, notably Denmark, Finland, Norway and Sweden, which have been governed by left-of-center social democratic parties for much or all of the post–World War II era. They combine a healthy respect for market forces with a strong commitment to antipoverty programs. Budgetary outlays for social purposes average around 27 percent of gross domestic product (GDP) in the Nordic countries and just 17 percent of GDP in the English-speaking countries.

On average, the Nordic countries outperform the Anglo-Saxon ones on most measures of economic performance. Poverty rates are much lower there, and national income per working-age population is on average higher. Unemployment rates are roughly the same in both groups, just slightly higher in the Nordic countries. The budget situation is stronger in the Nordic group, with larger surpluses as a share of GDP.

The Nordic countries maintain their dynamism despite high taxation in several ways. Most important, they spend lavishly on research and development and higher education. All of them, but especially Sweden and Finland, have taken to the sweeping revolution in information and communications technology and leveraged it to gain global competitiveness. Sweden now spends nearly 4 percent of GDP on R&D, the highest ratio in the world today. On average, the Nordic nations spend 3 percent of GDP on R&D, compared with around 2 percent in the English-speaking nations.

Friedrich von Hayek was wrong.

The Nordic states have also worked to keep social expenditures compatible with an open, competitive, market-based economic system. Tax rates on capital are relatively low. Labor market policies pay low-skilled and otherwise difficult-to-employ individuals to work in the service sector, in key quality-of-life areas such as child care, health, and support for the elderly and disabled.

The results for the households at the bottom of the income distribution are astoundingly good, especially in contrast to the mean-spirited neglect that now passes for American social policy. The U.S. spends less than almost all rich countries on social services for the poor and disabled, and it gets what it pays for: the highest poverty rate among the rich countries and an exploding prison population. Actually, by shunning public spending on health, the U.S. gets much less than it pays for, because its dependence on private health care has led to a ramshackle system that yields mediocre results at very high costs.

Von Hayek was wrong. In strong and vibrant democracies, a generous social-welfare state is not a road to serfdom but rather to fairness, economic equality and international competitiveness. SA

An expanded version of this essay is available online at www.sciam.com/ontheweb

Jeffrey D. Sachs is director of the Earth Institute at Columbia University.

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