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The welfare state needs a make-over

Different countries have different ways of organising welfare. Some countries, like the Nordics, have chosen to finance most welfare services through the public sector. In other countries, there is usually more of a mix of privately and publicly financed services. Regardless of the sources of financing, it will be more and more difficult to organize and afford welfare, going forward.

The need to deleverage debt in the private and public sectors in the crisis-struck economies will make it more difficult both for individuals and politicians to afford welfare. In addition, the demographic situation implies that fewer people in the labor force will support a larger group of elderly, i.e., the so-called dependency burden will increase. On top of that, as we have become richer, we are increasing our demand for welfare services. Also, technological development leads to higher costs for pharmaceuticals and other medical equipment. The question is, How can welfare states solve the equation of providing and financing welfare services in the future, as costs increase and tax income no longer can rise for this purpose?

The welfare gap is already here

The Swedish welfare system has so far disguised the financing gap that already exists. Health institutions make priorities on who has the right to obtain certain health services, but without being particularly transparent. Many will not receive the care they need, or they will have to wait in line longer than necessary. In other countries, meanwhile, the fees and insurance premiums increase to counteract the trend of more expensive welfare services.

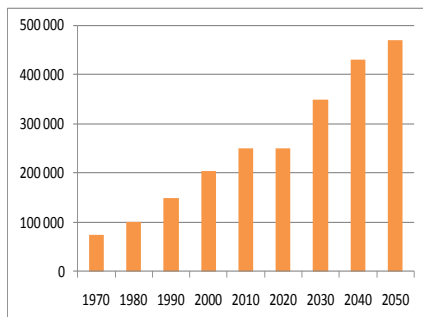
Between 1950 and 1980, Swedish taxes in relation to GDP increased from 20% to 50%, and afterwards the ratio stabilised at this higher level. As a result, more and more safety and services had to be provided by the individual, and reforms were made related to the pension system, the social insurances system, and housing.

Now the turn has come to analyse the welfare system of education, health, and care. It seems inevitable that private financing will have to fill the gap as it is difficult to increase the tax ratio much further. The problem is, according to the Swedish Borg commission (freely translated into English: *We can afford the future – but then a long-term and coherent welfare financing policy is needed*), that a gradually rising tax ratio is needed in order to sustain our present welfare system.

A luxury problem?

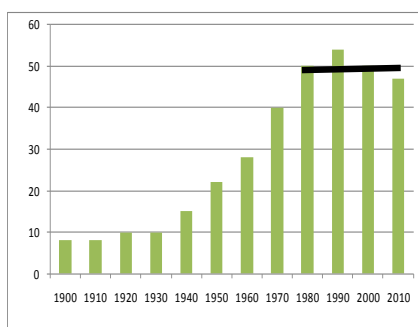
It may seem peculiar that a country where politicians and economists discuss whether the public debt should be eliminated completely or stabilised at around 35% of GDP has a welfare-financing gap. In other Western countries, the public debt is reaching some 100% of GDP. However, increasing public debt is not the way to finance welfare: unless the taxes in the municipalities increased some 10-20 percentage points, public consumption could not rise in line with GDP. It may also seem a luxury problem to discuss whether services should be privately or publicly financed. However, more is at stake. Without reforms, and without a long-term strategy, society may have to change in panic and with a loss of trust in collective policies.

Graph 1: The number of persons aged over 85 years in Sweden 1970-2050



Source: SCB and Borg Commission (2010)

Graph 2: Swedish taxes in relation to GDP (%) between 1900 and 2010



Source: Borg Commission (2010)

Courage to start reforms now

In Sweden, the demand and costs for services will increase faster than the financing sources. With unchanged policies, there will be a large gap between demand and supply. Therefore, many policies are needed to change, and over a longer period, in order to create a public welfare system acceptable to the majority of the population, rather than creating a suboptimal system out of panic.

Sweden's labour force works in a shirt sized "Medium," but the country has a welfare system labelled "Extra Large." So, first of all, there is a need to increase taxes without increasing tax rates, as globalization will ask for lower rates. There are a number of ways of doing so: 1) lowering the age of entrance into the labour market (i.e., graduating from universities somewhat faster), 2) staying longer in the labour market (i.e., postponing the retirement age until 70 years), 3) shrinking the number of those who don't participate in the labour market for various reasons (due to lower productivity than the minimum wage, or the society's negative attitudes towards young, old, or persons with foreign backgrounds), and 4) increasing the value added in production so that wages and taxes rise faster.

Second, welfare can be organised more effectively by using new technology, administrating resources smarter, enhancing education, and using better incentive systems. By having private actors *provide* the services, competition and effectiveness usually increase. Benchmarking among actors, regions, and nations is a good technique for finding ways to increase effectiveness.

Third, for a country like Sweden, there is a need to figure out what should be financed by the public sector, and what should be left for citizens to take individual responsibility for. The nontransparent prioritisation system is no longer valid, since it must be made clear what is part of the public concern and what is not, in order for people to make up their own minds on how to finance a service, by fees or by insurances.

No alternative to some private financing

There is no alternative for Sweden, and perhaps other Nordics, than to mix public and private financing of welfare services. Despite reforms that can raise taxes (but not tax rates), and increase effectiveness, this will not be sufficient to fill the financing gap. The most difficult task now is to figure out what types of health, elderly care and education should be part of the basic supply, and what shouldn't be. How much time is needed to phase in more private financing? How much more of the social insurance system has to become private? And also, if the tax system is progressive, how much more should high-income earners pay for the extraordinary supply? If it will cost much more for a high-income earner to get health services, this person's interest in paying higher taxes will diminish. The acceptance of the progressive tax system is broad at the moment, as high-income earners can also benefit from the public welfare system, but it is gradually shrinking. And perhaps that is the issue, What kind of system do we want? And how coherent should it be? And, at the same time, as in many debt-burdened countries, the question is rather, How to afford the services, regardless of whether they are private or public, and how to create trust? No time to waste – let's start answering these questions.

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