Scandinavian Irony: Socialism Meets Liberalization

BY SARA F. COOPER

Scandinavia is in the midst of an economic transformation. Thanks to tax reform, openness to investment/trade, sound property rights, little corruption, and continuing efforts to privatize, economies there have made great strides toward liberalization. Denmark, Finland, Iceland, and Sweden have been rated "free" economies by the Heritage Foundation's 2006 *Index of Economic Freedom* (online at www.heritage.org/research/features/index/countries.cfm). Norway lags behind with a "mostly free" rating.

Scandinavian countries have low corporate tax rates and transparent procedures to establish a business. Moreover, these countries have implemented numerous reforms over the past couple years. For instance, cutting income taxes has become one of Iceland's crowning economic achievements. Denmark has been ranked by the Economist Intelligence Unit (EIU) as having the best business environment thanks to, among other things, its flexible labor market.

Despite the good news about reform, other details remain grim. Sweden has extremely high taxes, which encourage workers to cut hours to avoid them. The Norwegian government continues to drag its feet on privatization, thus thwarting investment into the country. Additionally, the Scandinavian welfare state hinders productivity by enabling otherwise healthy workers to stay at home.

Johnny Munkhammar, director of the Swedish free-market institute, Timbro, wrote in *TCS Daily* in March that Sweden is like two different countries. One is a country that has pursued reform, the other a country that has held on to the "Social Model of a big state."

This could be said for all the countries of the region as they balance free-market reforms with generous welfare systems. For instance, every day about one-fifth of the workforce stays home in Sweden. These "potential" workers are receiving disability benefits or are on sick leave. "Almost everyone who requests sick leave is granted it," notes the OECD (Organization for Economic Cooperation and Development).

Economic Performance in Scandinavia

Country	Population	GDP Growth	Unemployment
Denmark	5.4 million	2% (2004)	6.4% (2004)
Finland	5.2 million	1.8% (2005)	7.9% (2005)
Iceland	296,737	6.5% (2005)	2.1% (2005)
Norway	4.6 million	3% (2004)	4.5% (2004)
Sweden	9 million	3.6% (2004)	5.5% (2004)

Source: Deloitte Touche Tohmatsu Country Guides in cooperation with the Economist Intelligence Unit (www.deloittecountryguides.com/index.asp.)

The Swedish government's aim is to help bridge the gap between sickness and work. But many take advantage of these benefits and use them as permanent income, as evidenced by the increase in disability and sick leave over the past decade. "The sickness rate of a Swede in his or her twenties, for example, is higher than the overall absence rate in all but four European coun-

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tries," the OECD said in a 2005 economic survey of Sweden.

Scandinavia also has generous paternity leave. In Iceland, fathers can take up to three months off while receiving 80 percent of their salary. Swedish couples are entitled to take up to 480 days (240 per person). The first 390 days pay 80 percent of parents' qualifying income, while the last 90 days pay a flat rate of 60 Swedish krona (about $8.40) per day. Not surprisingly, 95 percent of the high-rate benefit days are used.

"A total of 2.2 million people in Denmark received income-substitute benefits in 2003," according to the 2005 Danish Statistical Yearbook. The term "income-substitute benefits" includes sickness, unemployment, maternity, and social assistance. Many Scandinavians use these benefits as a means to earlier retirement.

In Finland "nearly 7 out of ten new retirees rely on some form of unemployment or disability payments," the OECD reported this year. On the other end of the age spectrum, generous benefits encourage the young to take their time with school, delaying entry into the workforce.

Whether they work or not, it's unlikely that Scandinavians will have to worry about having a roof over their heads. Several countries have housing programs. Almost 75 percent of the Finnish population, even high income earners, are eligible for government-subsidized housing, according to the OECD. Denmark manipulates the housing market through direct subsidies and price regulation. Sweden offers a housing allowance based on housing costs and the number of children in the household.

Paying for medical coverage isn't a concern either. Scandinavia's generous health-care system is well known, with the government continuing to pick up most of the tab. For instance, the EIU reports, the Norwegian system gives free treatment to all "with the exception of adult dental care and opticians." The government pays 84 percent of health-care costs.

Likewise, Iceland's central government covers about 85 percent of the costs, with patients contributing toward outpatient care and pharmaceuticals. Iceland has more doctors per 1,000 inhabitants than the United States and United Kingdom do. Finland has reduced health-care spending, paying about 76 percent of total costs in 2003. Finnish cuts have resulted in fewer hospital beds, falling from 11 for every 1,000 inhabitants in the 1990s to fewer than seven in 2004, according to the EIU.

Swedes Get Subsidized Health Care

Subsidized health care is available to all Swedish residents. Adults may be charged up to 900 krona (about $126), whereas children (anyone under 20) receive free care. Dental care, while subsidized from the national dental insurance, has been deregulated, allowing providers to set their own fees. Health care is largely a public-sector effort, with only 8 percent of physicians in private practice. Private insurers pay for less than 1 percent of health care.

Denmark's system gives coverage to everyone, although immigrants must wait six weeks for coverage to start. Health care is free, with the exception of "dental care and physiotherapy." Medication is subsidized. The majority of health-care costs, 86 percent, are covered by local municipalities, with the rest of the money coming from the central government (5 percent), private insurance (5 percent), and employers (4 percent), reports the EIU.

While free or heavily subsidized health care for all may sound ideal, the quality of the care is often far from it. The biggest problem may simply be access. Sweden has "a low proportion of general practitioners relative to specialists," notes the EIU. Swedes often have to wait a long time to be treated for nonthreatening conditions. A Swedish company, RelaxU, has turned this unfortunate reality into a profitable venture by working with Bangkok Phuket hospital to organize trips to Thailand for treatment. Leif Erre, RelaxU's head, states that in Sweden "the waiting period for an operation or treatment can be anywhere from two to eighty weeks." Such news isn't shocking when the Swedish government freely admits that "the health services in Sweden rest largely in the hands of local politicians in 21 geographical areas."

All is not well in Denmark either, as Danes have one of the lowest life expectancies in Western Europe. As costs have risen, standards have declined and waiting times have increased, according to the EIU. Danes have responded by taking greater interest in private insurance.

The number of people holding private policies rose from 1.1 million in 1991 to 1.75 million in 2004.

Finland also has a low number of general practitioners, and until recently Finns had to wait a long time for care. The government introduced waiting-time targets in 2005, and things have improved, according to the OECD. Norway has also implemented reforms thereby improving service, reducing waiting times, and increasing levels of treatment. But costs have risen steeply due to the volume of services and increasing salaries, says the OECD. Oil revenues give little incentive to impose cost-cutting measures.

Paying the Piper

Scandinavians may seem to have it all, with generous paternity leave, sick leave, education benefits, and cheap health care, but it all comes at a price. Scandinavians pay for these benefits with high taxes. The governments make no effort to hide this, as evidenced by this paragraph from a Danish government tax guide for new citizens:

"The tax rate in Denmark is one of the highest in the world, as Denmark has a very large public sector. The public sector looks after many things that people in other countries often have to pay for themselves or that may not even be available to the public. Danish society is expensive to run and thus requires a lot of tax funds."

Danes are subject to numerous taxes, including state income taxes and municipal, county, and church taxes. Tax rates are progressive and reach 59 percent. Income taxes were cut in 2004, and a tax freeze was implemented in 2001. The Danish Ministry of Finance projects that the tax burden as a percentage of GDP will fall from 50.1 percent in 2005 to 47.5 by 2007.

Taxes stifle business. A high tax on new cars makes innovation in the auto sector impossible, according to Ford's managing director in Denmark, Kenneth Jorgensen. Taxes and duties account for around 50 percent of GDP. Currently, corporate taxes are levied at 28 percent.

Sweden's tax burden was 50.5 percent of GDP in 2004. The OECD notes that some Swedes avoid taxes by working fewer hours or "operating in the black economy."

Swedish taxes are so high that even the Swedish tax authority doesn't want to pay them. A May 19 article in *Forbes* magazine noted that the Swedish tax authority produced television commercials in Estonia to escape the high taxes in Sweden. These commercials, which encouraged Swedes to pay their taxes on time, would have cost "50 to 100 percent more to make in high-tax Sweden." Despite having high personal income taxes, Sweden has low corporate taxes with a flat 28 percent rate. The inheritance and gift tax was abolished in 2004.

"Finns face a high personal tax burden, particularly when taken together with municipal tax, church tax and social insurance contributions," reports Deloitte Touche. Finland's corporate tax rate was lowered in 2005 from 29 percent to 26 percent. Finland's VAT (value-added tax) rate for goods and services is 22 percent.

Like the Finns, Norwegians face a heavy tax burden, with progressive income tax rates up to 51.3 percent in 2005. The wealth tax will be halved this year and cut again in 2007; the goal is to eliminate it eventually. Corporate taxes are 26 percent, and the VAT rate is at 22 percent.

Iceland's low corporate and personal income taxes are an exception to the rule, and they will go even lower thanks to reforms that started in 2004 and that will continue through next year. The general rate for personal income tax will be lowered to 21.75 percent by 2007.

Reforms introduced in 2002 have lowered corporate taxes from 30 to 18 percent (26 percent for partnerships), *Indsigt* magazine reports. These taxes are lower than they were in the early '90s, when the rate was 50 percent. "The largest single source of Treasury revenue is the value-added tax, which is levied at 24.5 percent on most goods and services," the Central Bank of Iceland reported last year. The VAT has also been targeted for reform.

Corporate rates in these countries are considerably lower than income tax rates, indicating that Scandinavian governments recognize the necessity of low rates to attract new investment.

Open for Business

These countries have a solid base for investment through their protection of property rights and strong rule of law. Moreover, they offer an educated workforce, a range of natural resources, and little or no corruption. In addition to low corporate tax rates, the

Scandinavians have made other notable changes to open the door to investment.

Privatization has come to these countries, thus increasing opportunities for investment, although some have been slower than others. The EIU notes that privatization has exposed "Denmark to increased competitive pressures" and has provided a "useful source of income for reducing public-sector debt."

According to the Invest in Iceland Agency, public ownership there is being "phased down by privatization and the main role of the public sector is in health, education and social welfare." Icelandic industrial policy has undergone changes over the past decade through implementation of "a more active competition policy replacing price supervision or even price controls that prevailed in many sectors," says the Ministry of Foreign Affairs.

Applications to establish a new business in Iceland are usually handled in one day. In business, time is money, thus Iceland's quick turnover results in lower overhead costs. Likewise, Denmark offers "quick, informal and cost-efficient establishment procedures," Invest in Denmark says. Denmark also offers an online registration system and boasts that a company can be incorporated "within a few hours."

Establishing a business in Sweden takes a little longer, about two to three weeks. Yet according to a report by the World Bank, it's worth the wait. A 2005 World Bank comparison of 145 countries found that Sweden is one of the world's top ten economies in "terms of ease of doing business."

Starting a business in Finland is easy. The Finnish government reports that 185 new foreign-owned companies opened their doors there last year. Finland's location aids its success in attracting new companies. "Finland is an attractive export base for the Baltic states and the regions of Russia bordering Finland," notes Deloitte Touche.

These countries also have a history of trade and are known for exports such as bacon, oil, autos, fish, timber, machinery, and cell phones. Their free-trade policies have contributed to their growth. According to the Heritage Foundation, Denmark, Finland, Norway and Sweden have a "low level of protectionism," while Iceland has a "moderate level."

Denmark, Finland, and Sweden are members of the European Union (EU). Iceland and Norway belong to the European Free Trade Association (EFTA) and to the European Economic Area (EEA). The EEA covers the 25 member states of the EU plus Iceland, Liechtenstein, and Norway.

Trade's contribution to these economies is significant. It accounted for 46 percent of Swedish GDP in 2003. The Swedish government credits surging exports as one of the main drivers in economic growth. Norway describes trade as part of the foundation to advance its economy.

Still Room for Improvement

These countries still have much room for improvement despite the strides that they have made toward liberalization. Scandinavian countries have a good deal to offer, yet their reluctance to radically reform the welfare system makes them their own worst enemy. According to Stephen Brugger, executive director at the American Chamber of Commerce in Denmark, it is impossible to maintain things the way they are while expecting different results:

> In other words you can't retain all of the safety mechanisms of the existing social welfare system and simultaneously grow a competitive, innovative and entrepreneurial economy. It is important that the government communicate to the population that we can't both renew ourselves and keep things the way they are, otherwise we will be outpaced by the countries surrounding us. It is necessary that we change some things fundamentally if we are to attract foreign investment.

A simple focus on productivity would do these countries a world of good. Excessive regulations cost productivity (and money) and thus will deter, not attract investment. As the U.S. Commercial Service acknowledges, Swedish "labor laws create an expensive market for low cost labor, making operations like franchising a challenge."

Attracting investment is one issue, while convincing Scandinavians to decline generous sick leave and go to work is another. Sweden's problem cannot be blamed on an uneducated workforce; on the contrary, it's the less skilled, for the most part, who are working while the educated stay home.

Sweden's official unemployment rate, 5.5 percent in April according to Statistics Sweden, should be viewed with skepticism. A recent study by the McKinsey Global Institute indicates that Sweden's real unemployment rate is around 15 percent. "McKinsey reached its conclusions by including those who want to work and those could do so, meaning people on government programmes as well as those on prolonged sick leave," according to the *Financial Times*.

These countries could learn a lot from Iceland. It has one of the highest labor-participation rates in the world, with older people staying in the workforce longer. Little Iceland has experienced larger growth and lower unemployment than the other countries. It seems that tax reform, privatization, and citizens who are willing to work befit growth.

Greater privatization opens the door to more investment. Although state ownership is declining in Norway, it still has a long way to go. The government owns some of the largest companies in Norway, such as Statoil, which is partially privatized, and Norsk Hydro. The government also owns other enterprises ranging from electric plants to banks. Norway's problems extend beyond its lack of privatization. Norwegian labor costs and taxes deter investment as well.

Scandinavia has taken notable steps toward liberalization and has benefited greatly from it. If history is any indication, greater liberalization will bring greater investment. This transformation depends in large part on political will. Various factors, including the competitive forces of globalization and the fiscal pressure of large aging populations, may convince their leaders that there's still work to be done.