

Improving the efficiency of a welfare state

Tarmo Valkonen

ETLA

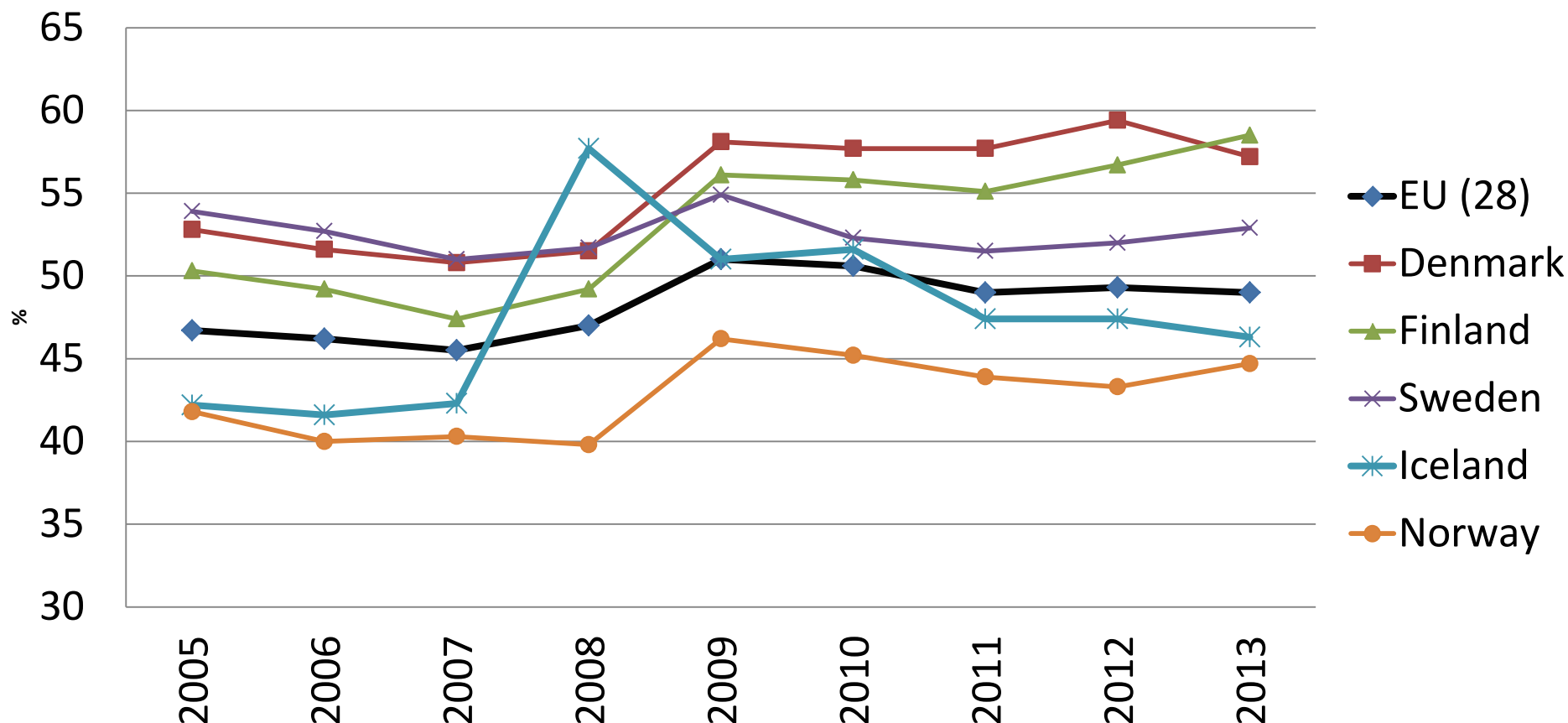
EDRC Seminar: Growth, Employment and Welfare –
Nordic lessons and perspectives,
OECD 11/06/2014

Some observations

- Public expenditure
 - Many of the highly valued services (health care) are financed and often also produced by public sector in Nordics.
 - Population ageing hits harder the Nordic welfare states due to the extensive public promise.
- Tax revenues
 - Promoting low income differences has a price:
 - High marginal tax rates for top incomes increases the mobility of the best educated and causes income shifting.
 - Means testing of the benefits of low income people reduces incentives to participate in labour markets.
 - Globalization increases mobility of jobs, but also the growth of real wages.
 - The pressure to increase jobs and growth has intensified corporate income tax competition.

High expenditure levels

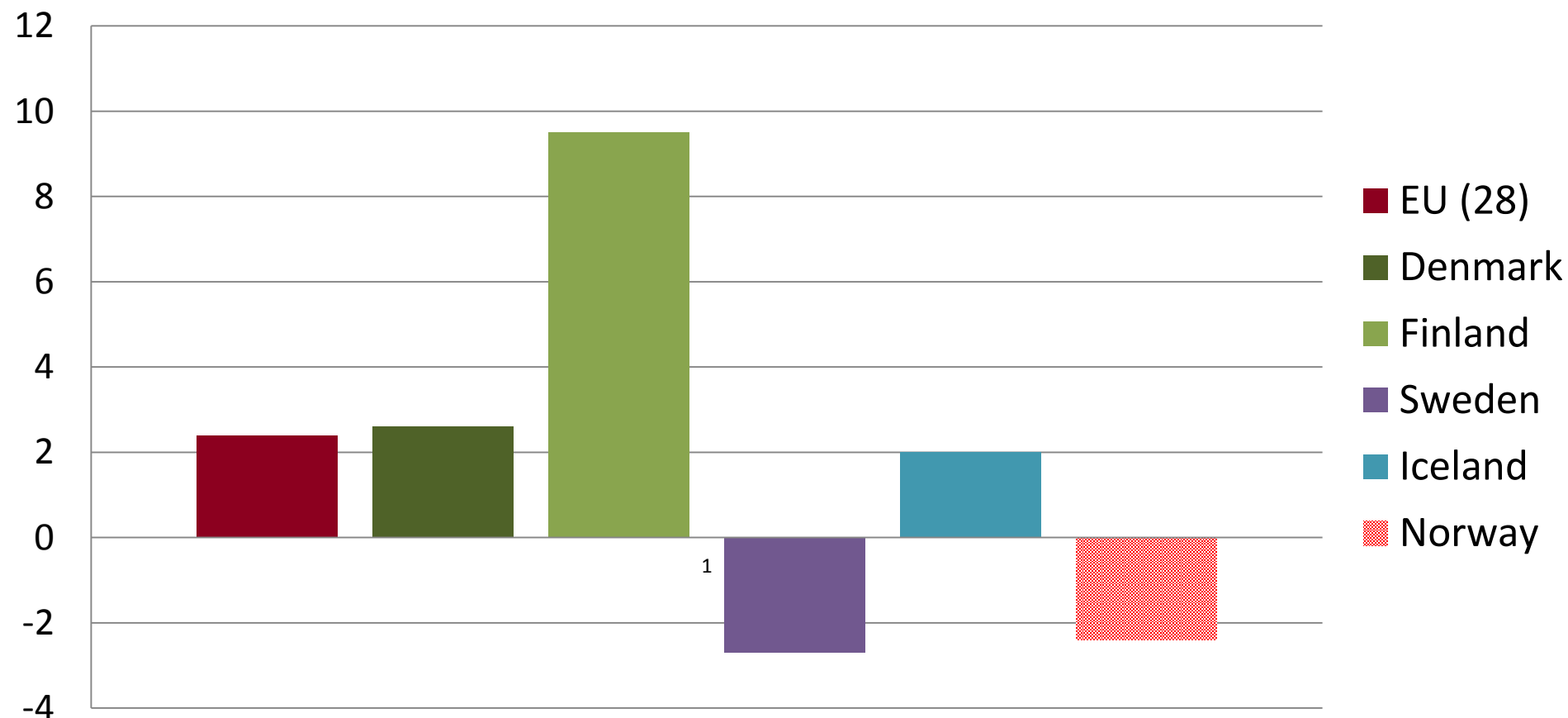
Public expenditure/GDP





Large variation in recent trends

Public expenditure/GDP change 2002-2013

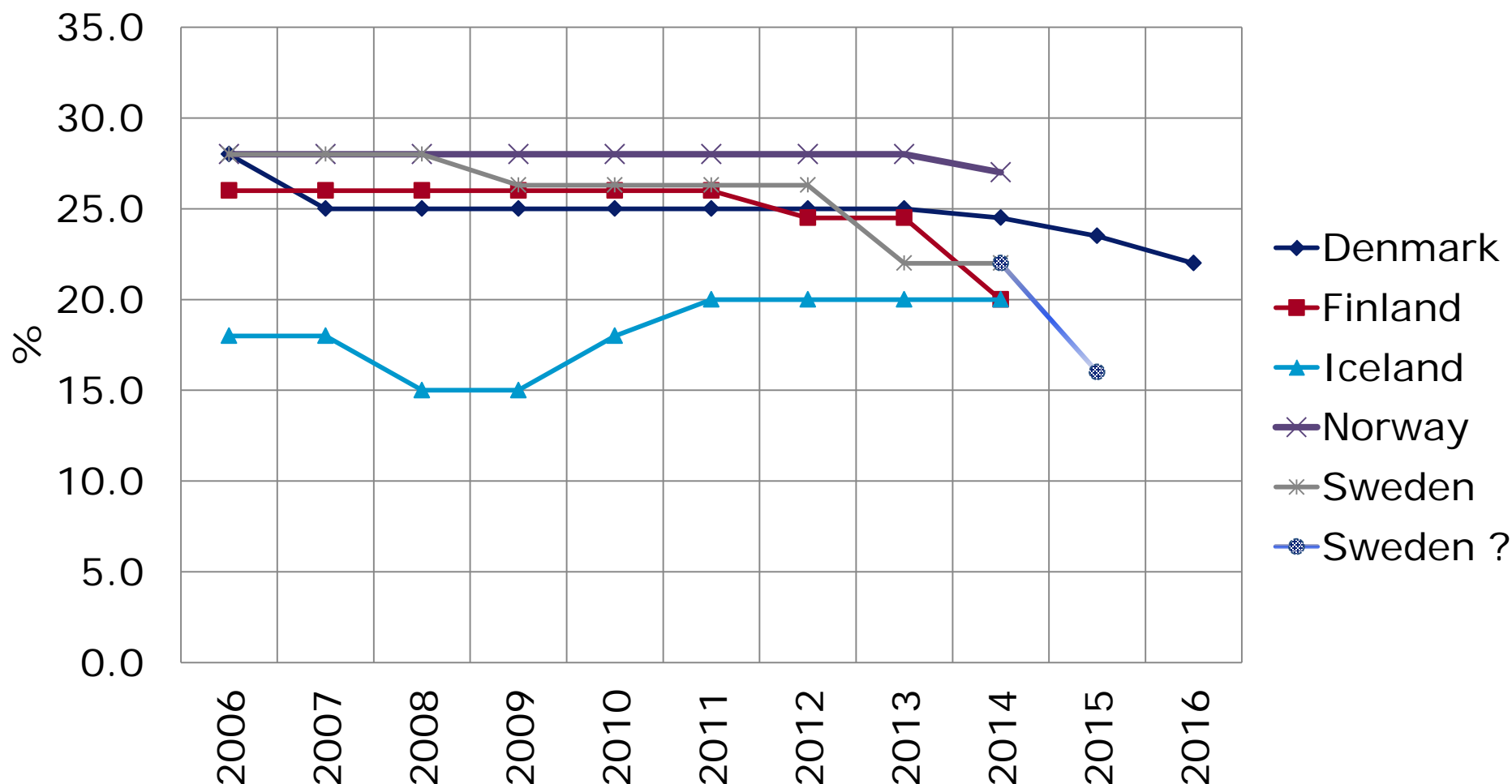


Intensified corporate income tax competition



norden

Hållbar nordisk välfärd

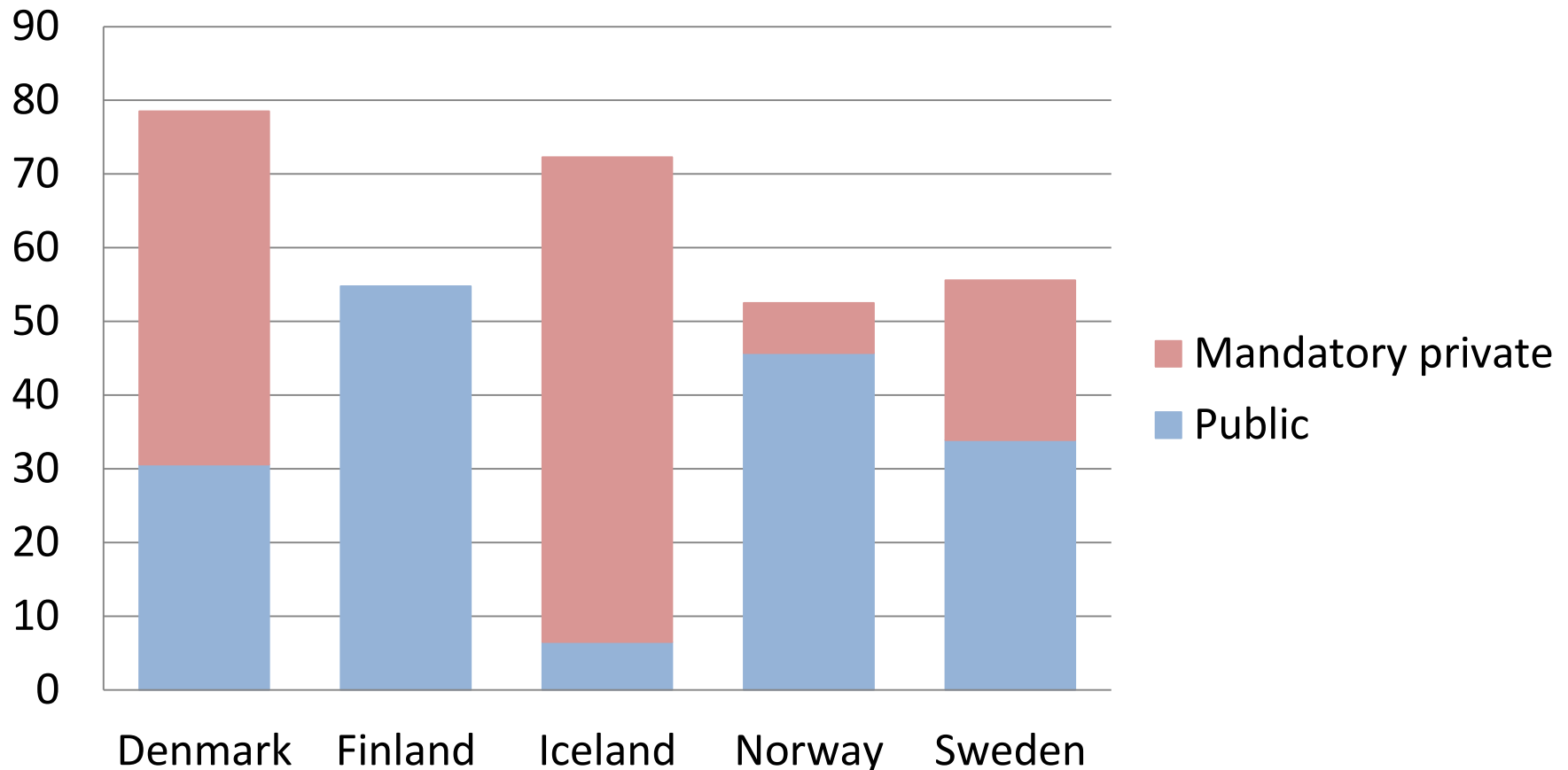


Some questions

- How to get enough tax revenues (from the increasingly mobile tax bases) to finance the ageing costs and to compensate for the increasing market income differences?
 - How to reap the benefits of globalization to increase growth?
 - How to increase the even now high employment rates, when there are pressures for labor taxes? The best means are already in use: good education and health care, links between contributions and benefits are tightened (pensions), employment-friendly public services (day care) are extensive.
- Are the current methods of financing the welfare state sustainable and intergenerationally fair?
 - Tax financing and pay-as-you-go principle.
- Have the Nordics reached the limits of universal and equal provision of public services?

How to measure the tax burden?

Pension replacement rates



Efficient and resilient tax system

- Broad based low rate taxation, immobile tax bases
 - Minimization of the often poorly targeted tax subsidies (housing, reduced VAT rates, tax allowances for firms).
 - Taxes on consumption and real estates can still be raised.
- Dual income tax + rate of return allowance for risk-free yield.
 - Corporate income taxes vs. capital income taxes
- Earned income tax credits to increase participation rates.
- User payments lower the demand of public services, generate revenues and are less distortive than taxes.

Additional notes about financing of services

- Fairness between generations: future quality and scope improvements should be paid by future generations (but included in sustainability gap calculations).
- How to top up the public services with private money (savings, voluntary insurances)?
 - Requires information about access to and cost of public services.

Less distortive income transfers

- From education subsidies to loans.
- Links between work and benefits should be tightened further :
 - Income transfers to unemployed conditioned to successful participation in education or acceptance of jobs offered.
 - Incentives to retire early removed, postponement rewarded fairly. A link between retirement age and life expectancy is less problematic from the point of view of equity than often claimed.

More efficient public services

- How to compensate for the missing incentives (created by markets) to be efficient in the public sector?
 - Soft budget constraints (power to tax)
 - Fiscal rules for municipalities.
 - No price mechanisms to show the costs and value of the services, no creative destruction (allocative efficiency)
 - Exposure to market mechanisms: outsourcing, customer choice
 - Basic requirements: competition, skilled purchasing, quality control, well-designed remuneration rules, informed customers.
- Digital technology, Operations Management.
- Better use of economics of scale.

Conclusions

- The trade-off between equity and efficiency has weakened due to the more mobile tax bases.
- There is room to improve both the equity and efficiency of the tax and transfer systems even in Nordic welfare states.
- Exposure to (market) steering mechanisms and controlled outsourcing is needed in the public provision of the services.
- Explicit rationing and prioritisation becomes necessary.
- Forward-looking policy rules are needed.



norden

Hållbar nordisk välfärd

Thank you!