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Opportunities and Threats Related to the Implementation of the So-Called Third Way Concept

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Abstract:

Purpose: *The purpose of this study is to answer the question if countries with relatively lower GDP per capita should build their wealth and competitiveness coping the Nordic socio-economic model of economic policy.*
Design/Methodology/Approach: *The research method used in this paper is primarily descriptive, comprising the analysis of various documentary sources of socio-economic Scandinavian model and data analysis conducted on that topic.*
Findings: *The results of the research show that expansion of government in Nordic countries has slowed growth, but slow growth for a rich nation is much less of a burden than slow growth in a poor nation. That means that sources of economic growth in countries with lower level of GDP per capita should be free market policy implementation, low taxes, flexible markets and a low contribution of the state to the GDP.*
Practical Implications: *The economic and social policy analyzed in the article might be an example for some countries to implement it.*
Originality/Value: *The value of this article findings is important for economic and social policy in the context of defining the sources of economic growth and risk of coping solutions from other countries.*

Keywords: *Socio-economic Nordic model, welfare state, economic growth.*

JEL codes: *O11, O23, P10.*

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1. Introduction

The crisis of liberal democracy - this thesis was very popular in 2016, especially after conservative-populist political groups gained more and more popularity and won elections, the British decided in a referendum that they wanted to leave the European Union, and Donald Trump became the 45th president of the United States. It seems that the Polish government, by negating the rules that have been in force so far that enabled Poland's civilizational leap after the communist period, is looking for its own path of development. The lack of a coherent strategy makes it difficult to find a reference point for what the government does and plans in terms of broadly understood development policy.

On the one hand, costly social programs are being implemented, the superiority of public over private ownership is being emphasized, the principles of international cooperation based on credibility are being ignored, and on the other hand, further fiscal burdens are being introduced under the pretext of social justice. While negating socialism as a system, its principles are used in an attempt at building economic concepts that - in theory at least - are to provide the basis for the acceleration of the economy in terms of real GDP.

In this context, it is worth referring to the so-called concept of the third way, which is pointed to (especially by the left side of the political spectrum) as the source of socio-economic success of the Scandinavian countries. The UN's annually published Human Development Report includes a ranking of most livable countires in which the top spots belong to Norway, Denmark, Sweden and Finland.

Those countries share the so-called Nordic model of development, commonly associated with a relatively large public sector, generous welfare system and high-quality public goods. The aim of this article is to try to answer the following questions: Why are the Nordic countries relatively rich? Does the implementation of the welfare state strengthen the economic competitiveness of the Scandinavian countries? Can EU poorer countries adopt socio-economic Scandinavian model.

2. Literature Review

The development of the Nordic model as a concept in international discussion and the pattern to copy for other countries made it is roughly outlined by a quantitative analysis, books and reports.

According to Sanandaji (2015), Scandinavia's success story predated the welfare state. In the period from 1870 to 1970 the Nordic countries were among the world's fastest-growing countries, thanks to a series of pro-business reforms, low level of taxes, property rights, free markets and the rule of law combined with large numbers of well-educated engineers and entrepreneurs. But in the 1970s and 1980s the undisciplined growth of government caused the reforms to run into the sands and

Sweden dropped from being the 4th richest nation in the world to the 13th richest nation in the world. Mitchel (2007), asserts that Nordic nations are reasonably successful in spite of the welfare state. Nordic countries benefit from institutions—such as property rights, stable currencies, and the rule of law—that facilitate economic growth. And although they have large welfare states and concomitantly high levels of taxation, their economic systems in other respects are very market-oriented.

According to Chrupczalski (2010) Sweden can run its social and economic experiments thanks to diligence of former generations. Although, Sweden looses with other market orientated countries. The changes that happen in Sweden show that welfare state seems to be utopia and when the social cooperation start to fall apart, the only rescue is to come back to capitalism. Torben *et al*. (2007) states that responsible nordic politicians will have to understand and acknowledge that it is largely the same people who enjoy the benefits of entitlements and who finance their increasing costs. There is no unused reserve of resources that can be tapped – nor is there some unexploited tax base that could generate significant financial leeway. The resources that are needed will have to be generated through productive activity; we cannot afford free-riders.

People have to work more – start their working careers earlier, work more hours on average, and retire later. The Nordic model can be defended and upheld – but only through reforming its institutions and policies while reiterating its commitment to a proper balance between the entitlements and responsibilities of its citizens.

To deal with disruption and support long-term competitiveness, advocates point to public provision and free or low-cost access to a wide range of public services as a winning approach. But the Nordic countries' unique cultural circumstances that allow this welfare model to succeed and argue that these generous benefits come at a great price some of the highest personal taxes in the world to fund the large public sector (Deloitte Development, 2020).

3. Methodology

The research method used in this paper is primarily descriptive, comprising the analysis of various documentary sources of socio-economic Scandinavian model and data analysis conducted on that topic.

4. Research Results and Discussion

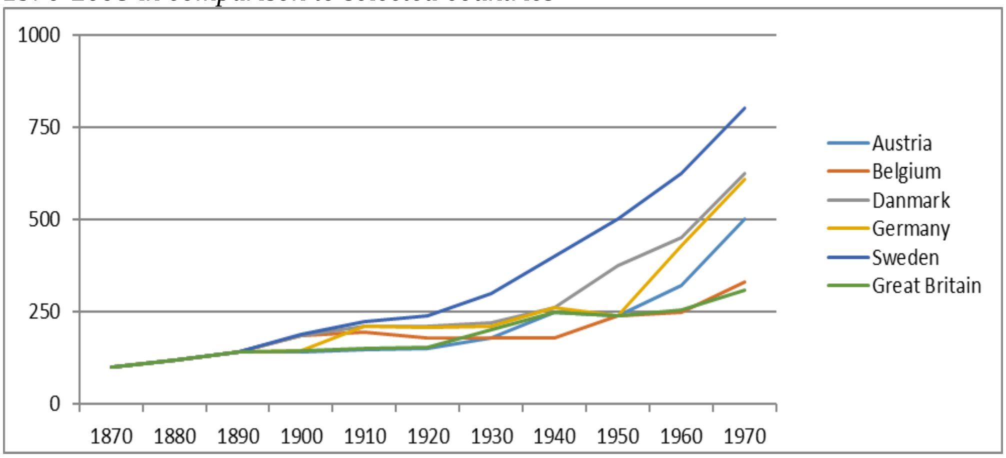
4.1 Scandinavian Countries Sources of Success

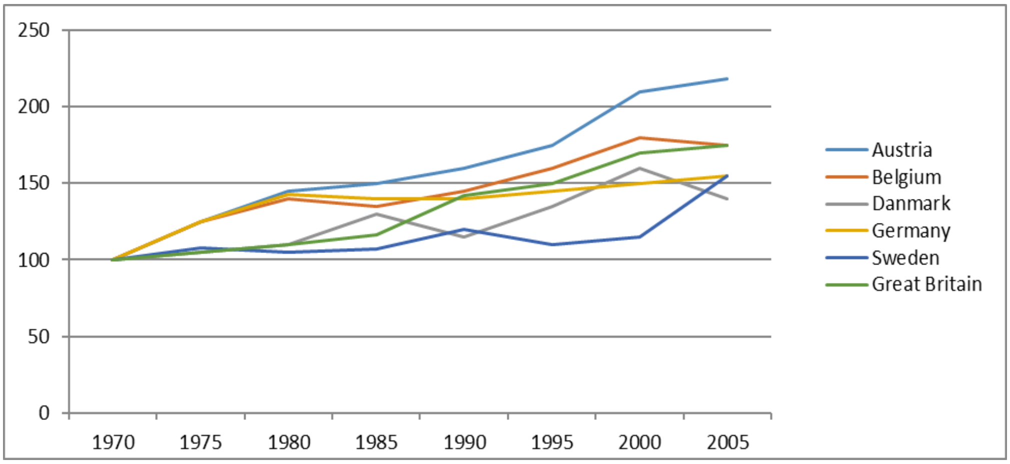
The high level of trust in the authorities and public institutions, work ethos and social cohesion were the factors that laid the foundations for the implementation of the welfare state model.

Scandinavian countries are illustrated as an example that the so-called third way policy linking socialism with capitalism is working. So, can other countries achieve similar socio-economic results by increasing the state's participation in the economy? If the solution were so simple, probably all European Union countries, and not only, would implement a development policy based on the experiences of the Nordic countries.

It turns out that a simple solution does not work and the sources of success of the Scandinavian economies are different from the premises of the welfare state. The solid foundations for economic growth in the Nordic countries should be linked to periods of free market policy implementation, low taxes and a low contribution of the state to the GDP.

Figure 1. *Growth dynamics of GDP per capita in Sweden in years 1870-1970 and 1970-2008 in comparison to selected countries*





Source: *Sanandaji, 2015.*

In the years between 1870 and 1936 the dynamics of GDP per capita in Sweden was the fastest among all industrialized countries. From 1870 to 1970, it was a country with a relatively small share of the state in the economy. Neutrality during World War I and II and the lack of the need to rebuild the country from the devastation of war meant that the process of catching-up in terms of GDP per capita was three times faster than in Great Britain. In 1870 income per capita was 57% higher than that of Great Britain, and in 1970 it was 21% higher.

However, without a doubt, the transformation in the economy represented by the growth of the public sector initiated in the 1970s weakened Sweden's wealth accumulation process and its leadership position in the pace of production growth. In Denmark, the pattern of development was very similar. From 1924, that is from the gradual introduction of the social-democratic model and associated moderate increase in the fiscal burden, the dynamics of GDP per capita decreased significantly: in the years 1870-1924, Denmark ranked 6th in this respect, while in the period 1924- 2008 it dropped to the 16th. Finland began to implement its welfare state after the collapse of the USSR and after regaining full independence. In Norway, on the other hand, the welfare state has been consistently built since the end of the Great Depression in the 1930s, and undoubtedly the discovery of oil and natural gas in 1969 proved beneficial to that.

4.2 Welfare State – An Opportunity or a Threat?

The 1970s were a strong focus of the Scandinavian economies on the development model determined by the third way policy, which as intended, has to be a compromise between socialism and capitalism.

Table 1. *Share of taxes in GDP in selected countries.*

	1955	1965	1975	1985	1995	2005	2015
Sweden	24	31	39	45	46	47	43
Danmark	23	30	38	45	48	50	47
Finland	27	30	36	39	45	42	44
Norway	28	30	39	43	41	43	38
Great Britain	30	29	34	36	32	34	32
USA	24	24	25	25	27	26	26

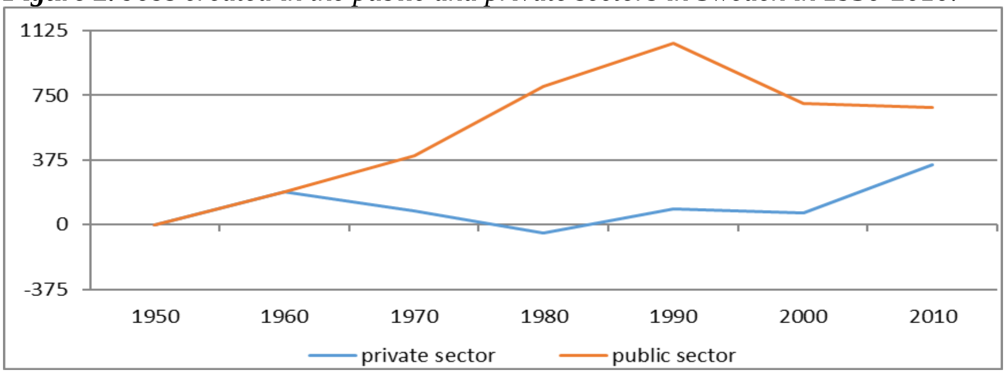
Source: *https://data.oecd.org/tax/tax-revenue.htm#indicator-chart, accessed: March 2017)*

An analysis of the data in Table 1 shows that until the 1970s a transition to the welfare state model was gradual and pragmatic, and was reflected by a moderate increase in the fiscal burden. The decision to raise taxes was based on a desire to provide high-quality public goods such as health protection, education and infrastructure. During this period, individual Nordic countries had a higher share of fiscal burdens in GDP than Great Britain, which in the 1950s was the leader in this respect.

Research conducted by M. Trabandt and H. Uhlig showed that the level of taxes on personal income in Denmark, Finland and Sweden was approaching the tipping point on the Laffer curve - which when exceeded results in a decrease of revenues to the state budget (Trabandt and Uhlig, 2010). In the case of capital gains tax, this point was exceeded in Denmark and Sweden, which means its reduction will result in increased budget revenues (Trabandt and Uhlig, 2010). The 1970s was the period of popularization of socialist ideas, which fell on fertile ground particularly in Sweden. The magnitude of the increase in the tax burden on entrepreneurs in this country resulted in an unprecedented decline in the number of new businesses. In 2004, only 38 out of 100 Swedish highest revenue companies had been established as private. Only two out of these 38 were established after 1970. If one were to rank companies according to their number of employees, those established before 1970 would be in the lead. Sweden is not the only one dependant on large companies that were established before the change of the economic policy towards the welfare state.

It is also characteristic of Norway, and Nokia, founded in 1865, that contributed to 25% of the GDP growth in 1998-2007 and had a 20% share in exports. In Sweden, there was a classic "crowding out" phenomenon present. The increase in taxes and legal regulations affecting entrepreneurship resulted in weakening of the incentives for setting up private businesses. For 50 years between 1950 and 2000, the population of Sweden increased by 2 million (from 7 to 9 million). At that time, the private sector practically did not create new jobs. The initiative in this regard was taken over by public enterprises.

Figure 2. *Jobs created in the public and private sectors in Sweden in 1950-2010.*

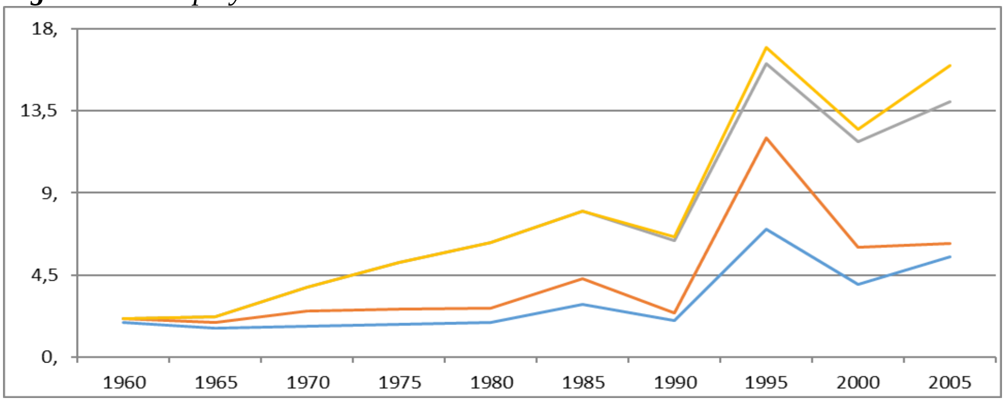


Source: *Sanandaji, 2015.*

The analysis of Figure 2 shows that the process of creating jobs in the public sector was dynamic until the end of the 1980s. After that a reverse trend is observed in this respect, due to the fact that the fiscal burden was already at such a high level that further employment growth was not possible. This means that the possibilities of creating new jobs throughout the economy were limited. It is also worth emphasizing that a generous social system and high taxes cause work demotivation. Between 1950 and 1997 one can observe a decrease of 32% and 17% in the number of annual hours worked in Denmark and Sweden respectively, while simultaneously there was an increase thereof in the USA.

Ljungqvist and Sargent point to the creative approach to the Swedish labor market statistics. The official data estimate the unemployment rate at around 5%. That, however, do not take into account those in a premature retirement (early retirement), those who live on sickness benefits (long-term sick) and those participating in various types of government programs (labor market programs) (Ljungqvist and Sargent, 2006).

Figure 3. *Unemployment rate in Sweden in 1960-2005.*



Source: *Ljungqvist, Sargent, 2006.*

Figure 3 shows that the real unemployment rate in Sweden is several times higher than the official statistics and ranges between 14% and 18%. Ljungqvist and Sargent point to the negative effects of legal protection of employment and a generous system of social support for the unemployed and the labor market. One must strongly emphasize that the implementation of the welfare state in the Scandinavian countries was possible because of their culture based on social cohesion, confidence in the public authorities and a work ethos combined with economic freedom and low taxes.

These, one can say, ethnic features of the Scandinavians have become part of the tradition and culture developed over the years. Furthermore, it takes time for these values, especially the work ethic, to be undermined by the assumptions of the welfare state. This is what happened in Sweden, where employees started using social benefits in an unjustified way. One of the widely recognized measures of socio-economic development level is life expectancy index.

Moreover, it is a sub-index within total HDI. It is generally accepted that a high life expectancy is a reflection of a properly conducted social policy and welfare.

Table 2. *Life expectancy in selected countries in 1960, 2005 and 2014.*

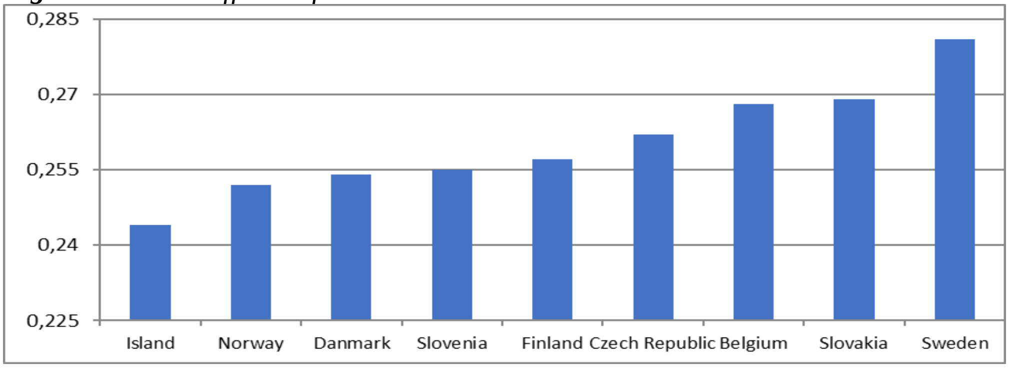
1960			**2005**			**2014**		
	Rank	Age		Rank	Age		Rank	Age
Norway	1	**73,6**	Japan	1	82,1	Hong Kong	1	84
Netherlands	2	73,5	Switzerland	2	81,3	Japan	2	83,5
Sweden	3	**73**,1	Island	3	81,2	Italy	3	83,1
Island	4	72,8	Australia	4	80,9	Switzerland	4	83
Danmark	5	**72,4**	Spain	5	80,7	Singapore	4	83
Switzerland	6	71,6	**Sweden**	6	**80,6**	Spain	5	82,6
Canada	7	71,3	Italy	7	80,4	Island	5	82,6
New Zealand	8	71,3	France	8	80,3	Israel	6	82,4
Australia	9	70,9	Kanada	9	80,2	Australia	6	82,4
Great Britain	10	70,8	**Norway**	10	80,1	France	7	82,2
Finland	22	**69,8**	Great Britain	17	79	Sweden	7	**82,2**
			Finlandia	18	**78,9**	Canada	8	82
			Danmark	22	**77,9**	South Korea	9	81,9
						New Zealand	10	81,8
						Norway	12	**81,6**
						Finland	17	**80,8**
						Great Britain		**80,7**
						Danmark	20	**80,2**

Source: *Wallen and Fölster, 2009.*

The analysis of the data in Table 2 shows that a high share of state in an economy is not a necessary condition for effective social policy, including health protection and education, which translates into high life expectancy rates. Norway, Sweden, Finland and Denmark with lower taxes and a smaller state did better in this regard. The choice and implementation of the so-called third way did not increase the level of development in terms of life expectancy, which is reflected in the ever lower ranking positions of the Scandinavian countries and the shrinking life span gap between Norway and Great Britain. The lack of a clear relationship between life span and implementation of welfare state is confirmed by the example of Iceland with a relatively smaller public sector (approx. 36% in relation to GDP) than other Scandinavian countries and, simultaneously, a higher life expectancy rate.

In regard to the countries that are leaders in this field today, a conclusion can be drawn that life expectancy depends more on cultural conditions, lifestyle and health care system than on a degree of state involvement. It is quite commonly recognized that a successful welfare state is represented by implementation of egalitarian values and relatively small income inequalities. The research of Atkinson and Sogaard (2010) shows that in the case of the Scandinavian countries (Denmark, Sweden and Norway), the greatest reduction in income inequality happened in the years 1900-1970, reaching the lowest level in the 1980s, and later it increased again reaching the values from the 1970s (Atkinson and Sogaard, 2010).

Figure 4. *Gini coefficient for selected OECD countries in 2014.*



Source: *http://www.oecd.org/social/income-distribution-database.htm.*

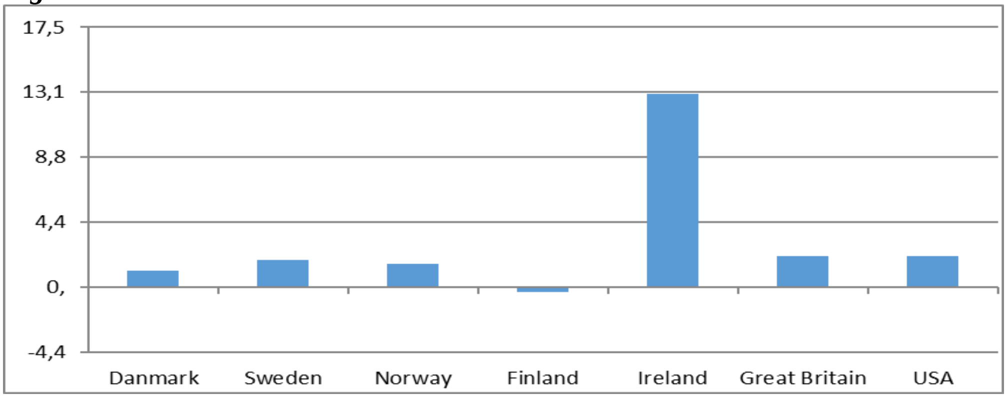
The analysis of the data in Figure 4 confirms to some extent the validity of the thesis that the implementation of the welfare state policy translates into relatively low income inequalities. However it is true to some extent, because the top positions in the ranking are taken by countries where the redistribution scale is much smaller than in the Scandinavian countries (Slovenia, Czech Republic, Slovakia). Particularly noteworthy is the high position of the Czech Republic and Slovakia and the flat income tax that is in force there, which may undermine the opinion about the positive impact of tax progression on social justice. On the global scale the modern economy leads to a widening of the income gap between those highly or less educated. Undoubtedly, in this context, a large role in the breakdown of revenues is played by the government policy, which does not necessarily mean higher taxes and overdistribution.

4.3 Economic Efficiency in the Scandinavian vs Liberal Model

There is no country in the world that would create prosperity and wealth by implementing the welfare state policy with a large share of the state in the economy.

The Nordic countries are a notable example of that. The "third way" is a consensus in the redistribution of wealth accumulated under the conditions of low taxation, stable institutions, and an international division of labor. Numerous studies confirm a negative correlation between the state's share in the economy and economic efficiency. Economic efficiency is the basis for the implementation of the welfare state. The reverse relationship does not exist. This is especially important for low and middle income economies whose authorities, infatuated by the socio-economic effects of the implementation of the third way concept, are inclined to adopt such a model.

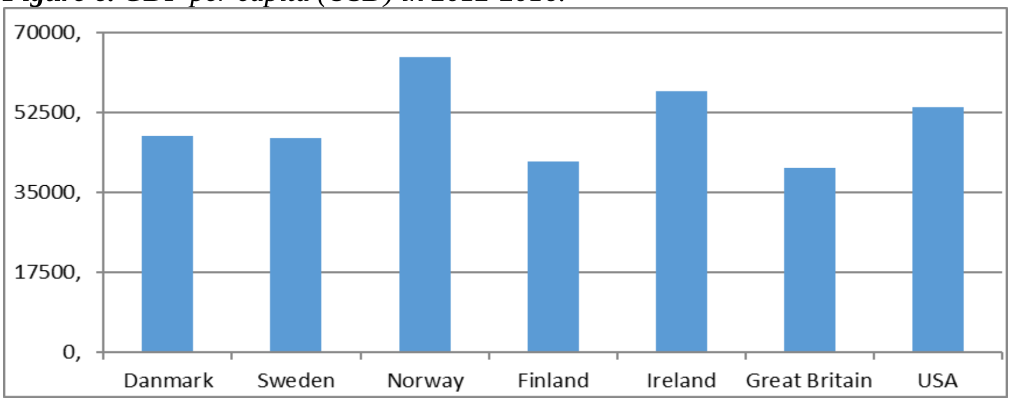
Figure 5. *Real GDP in 2012-2016.*



Source: *https://data.oecd.org/gdp/real-gdp-forecast.htm#indicator-chart.*

A comparative analysis of the economic condition of the Scandinavian countries versus those with a liberal approach to the economy, in 2012-2016, in terms of real GDP, is definitely in favor of the latter. Leaving aside the unprecedented pace of economic growth in Ireland in 2015, caused by the transfer of a share of foreign investors' profits, the average GDP in the US, UK and Ireland reached 3.5%, compared to 1.02% in the Nordic countries.

Figure 6. *GDP per capita (USD) in 2012-2016.*



Source: *https://data.oecd.org/gdp/gross-domestic-product-gdp.htm#indicator-chart.*

If one used GDP per capita as the determinant of the economic condition, then an average resident of the Nordic countries’ target group would be characterized by the same level of wealth as a resident of the "liberal three". The above analyses prove that the positive aspects of the implementation of the so-called the third way should not be directly linked to an increase in the state's share in the economy and the broad share of redistribution. Nevertheless, despite high taxes and a generous social security system, the Scandinavian economies are characterized by high efficiency and the fact that they are invariably at the top of the rankings regarding competitiveness, legal and institutional conditions for conducting business, or innovation.

Table 3. *Business environment, competitiveness, innovation and openness of Scandinavian economies compared to selected countries.*

	Global Competitiveness Report			**Doing Business**		**European Innovation Scoreboard**		**Globalisation index**
	1998	2005	2017	2004	2017	2004	2017	2017
USA	3	2	3	3	8	3		79,93
Great Britain	4	11	7	9	7	8	8	87,26
Ireland	11	30	23	11	18	12	6	92,15
Sweden	23	3	6	1	9	1	1	87,96
Danmark	16	5	12	8	3	6	2	88,37
Finland	15	1	10	3	13	2	3	86,3
Germany	24	13	5	4	19	5	4	84,57
Norway	9	6	11	5	6	13		83,50

Source: *Global Competetiveness Report, Doing Business, European Innovation Scoreboard.*

The analysis of the information in the table shows that the Scandinavian countries remain at the forefront when it comes to competitiveness, innovation, the level of economic openness, or the legal and institutional business environment. Nevertheless, a clear tendency is clearly seen for countries with an Anglo-Saxon socioeconomic model to gain position in these rankings. In general, bearing in mind the liberal sources of success of the Scandinavian countries, the model of the welfare state with a highly competitive economy and fiscal stability has been successfully implemented in that region since the 1970s. Institutional efficiency, stability of law and currencies, respect for property ownership rights and, despite high taxes, market-oriented economic system seems to be not without significance. It seems that such a concept of socio-economic policy could be a response to the challenges of globalization and the growing populist-nationalist tendencies in Europe and the United States.

5. Conclusion

Before the 1960s, Nordic nations had modest levels of taxation and spending. They also enjoyed—and still enjoy—laissez-faire policies and open markets in other areas. These are the policies that enabled Nordic nations to prosper for much of the 20th century. Once their countries became rich, politicians in Nordic nations focused on how to redistribute the wealth that was generated by private sector activity. This sequence is important. Nordic nations became rich, and then government expanded. This expansion of government has slowed growth, but slow growth for a rich nation is much less of a burden than slow growth in a poor nation.

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