

Mancur Olson:

## How Bright are the Northern Lights? Some Questions about Sweden

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## Chapter 6

### The Lower Costs and Ultimate Limits of Explicit Redistribution

The evidence presented in Chapter 2 revealed a remarkably clear and strong pattern. Among the 41 less developed countries studied by the World Bank, there was a regular tendency for the outward-looking countries to perform better than the inward-looking or protectionist countries. The large number of internationally successful industries studied by Michael Porter and his associates were systematically industries that had not been significantly subsidized or protected from either international or domestic competition. Most strikingly, in all smaller countries on which data were available, high protection of manufactures was strongly associated with the failure to export significant manufactures on competitive world markets. In addition, great increases in the size of a trading area and in the jurisdiction that determines trading policy were also regularly associated with great accelerations in economic development. The evidence on protectionism and jurisdictional integration was so overwhelming that some fairly strong conclusions could be drawn whether or not all of the other variables relevant to industrial development have been included in the analysis: the evidence was a bit like that on plane crashes whose adverse impact on the longevity of the victims is clear even without taking into account the many other variables that affect life expectancy.

This makes it all the more puzzling why the national-level evidence presented in Chapter 1 did *not* show *any* strong relationship in either direction between sizes of the governments or the extent of transfers to low-income people and economic growth. Because of what we know from observing what happens in individual markets, we should expect that properly specified statistical tests would show that an unusually large and growing welfare state would make a country's rate of economic growth (though by no means necessarily its level of utility or welfare) measurably lower than it would otherwise be. Yet from the fixation in ideological debates - and even from some leading

economists' contributions to these debates - we have been led to expect that the extent of transfers to low-income people and the size of the welfare state were of decisive significance for the fate of nations: many people obviously take it for granted that transfers to low-income people are so overwhelmingly important for economic growth and human welfare that their impacts would be clear even in analyses that neglect other relevant variables. But the effects of transfers and the size of the welfare state on economic growth are evidently not colossal enough so that, like the effects of plane crashes on longevity, they overwhelm other factors. So we must ask why hasn't the adverse effect of a larger welfare state on economic performance been strong enough to overwhelm all other factors and thus to produce a striking pattern in the cross-national and historical comparisons reported in Chapter 1?

The conceptual framework presented in the last three chapters suggests a possible answer. These chapters have shown that there are powerful incentives for organized groups to seek implicit redistributions and preferably implicit redistributions that achieve their objectives by altering relative prices rather than through the government budget. The indirect and concealed character of these redistributions - and the high degree of conditionality that is needed to conceal their redistributive purposes - usually makes them more costly to society.

If the argument that has been offered so far in this book is correct, there is no reason why the amount of redistribution to low-income people, and even the share of the government in GDP, should be closely correlated with the total social costs of redistribution. It is true, as critics of large welfare states say, that redistributions generate deadweight losses, but it is wrong to jump to the conclusion that the countries that have the largest amount of explicit redistribution to low-income people, or the largest share of the government disbursements in GDP, lose the most from redistribution. Countries in which less is transferred to the poor and in which the government is smaller can easily lose more from redistribution than the countries with the largest welfare states do. That is probably the main reasons why, as we saw in Chapter 1, there was no strong correlation, either for the developed democracies or for all noncommunist economies, between the relative size of the public sector and the rate of economic growth.

The main purpose of this study is, as the subtitle indicates, to ask some questions about Sweden. So what does the intellectual framework developed in the last three chapters tell us about Sweden?

As we try to answer this question, it is important to keep in mind that there is no lack of implicit redistributions in Sweden (and in the other countries with the most generous welfare states). The argument in the prior chapter that there are often large losses from implicit redistribution is, I believe, definitely applicable to Sweden.

But is Sweden the country that loses the most from *implicit* redistributions? Or even one of the countries that loses the most? I doubt it. We must postpone any final answer until there is further research - the main purpose of this study is to generate new questions. Yet I find it hard to imagine that anyone would argue Sweden was unique in the extent and costliness of its implicit redistributions. I have found it more difficult to

find examples of strikingly costly implicit redistributions in Sweden than in most other countries. What reason is there to think that Sweden would be losing more from implicit redistributions than other countries? Why would it be losing relatively more than Argentina? Or Ireland? Or Britain and most of the other English-speaking countries? Why would it be losing more than the average country in Western Europe (not to mention those of Eastern Europe and the developing nations)?

Although we must postpone any final conclusion until the experts on Sweden have researched the matter, my working hypothesis until then is that Sweden is *not* the country that suffers the most from implicit redistribution, nor is it probably even close to being in this position. I hypothesize that Sweden is doing as well as it is in comparison to many other countries because its performance is not dragged down as much by implicit redistribution as that of some other countries is. The losses from implicit redistribution in the countries which have the most of it are so large that they more than offset Sweden's larger losses of measured output because of its relatively large explicit redistributions to low-income people.

### ***What Limits the Amount of Implicit Redistribution in Sweden?***

One major factor that, I believe, keeps down the quantity of implicit redistribution in Sweden is the country's relatively high resistance to tariff and quota protection for manufacturers. Certainly Sweden does not lose as much from implicit redistribution through protection of manufactures as some countries do. The statistics and the historical evidence in Chapter 2 suggest that this is a matter of extraordinary quantitative importance. The argument in Chapter 5 suggests that this relative openness to imports of manufactures also reduces the amount of implicit redistribution in Sweden's labor market and in some other factor markets as well.

This raises another interesting question: Why is Sweden somewhat more favorable to free trade in manufactures than many other countries? It would take far too long to analyze this question adequately now, so I shall merely refer to some of the relevant arguments here. Perhaps one factor is the historical accident that modern Swedish (and Danish and Norwegian) industrial development began in part through primary product exports in the nineteenth century, especially to free-trading Britain, which was then about the most prosperous country in the world. The Scandinavian countries exported dairy products, timber, oats, shipping services, and iron ore, for example, in the period in which their catch-up growth began in the nineteenth century. Although I could easily be wrong, I sense that many modern Scandinavian manufacturing industries began with the processing or development of primary product exports. Logs were in time processed into finished lumber, then into paper, and finally into sophisticated paper products; iron ore exports ultimately turned into exports of iron, steel, and finally into exports of complex manufactured goods; exports of dairy products

from Scandinavia maybe had something to do with the invention in Sweden of the cream separator.<sup>1</sup> I do not know enough about the matter to draw any final conclusions, but it would be useful for someone to look into the possibility that this apparent symbiosis between primary product production for export and manufacturing, especially in the context of the contemporary British example and advocacy of free trade, encouraged early Swedish manufacturing interests to be more favorable to exports and to free trade than they might otherwise have been.

Probably another factor is the quality and influence of professional economists over the course of modern Swedish history. Though more of the giants of economic thought have come from Britain than from Sweden, the Swedish contributions have been extraordinarily large in relation to the size of the country - Sweden is, perhaps, the country with the largest per capita contributions to the subject. Often Swedish economists have also had a considerable influence on economic policy and on the thinking of the intellectual class in general.

It might seem that my earlier argument about rational ignorance and the role of self-interest in political life would rule out any influence of ideas on economic policy, but that is not the case. As I have argued elsewhere,<sup>2</sup> those with a professional stake in a subject do not find it rational to be ignorant of that subject. Although intellectuals are as susceptible to self-interest as other people, their selfish interests are more likely to show up mainly in those matters in which they have an immediate occupational stake (such as their own pay and tenure), rather than in the typical public policy issue; individuals in a variety of social roles are like a judge or a member of a jury in the sense that their individual self-interest does not bear in any important way on the matter at hand. So there are some people who have both an incentive to become informed about a public issue and a reason to look at it in a public-spirited way, and ideas can exert an influence through them.

Therefore, in spite of my emphasis on the importance of organized vested interests, I believe that the quality of ideas is also an important determinant of what policies and institutions a country chooses, and that Swedish economic performance over the long run has probably been helped by the country's strength in economics. It appears that public opinion about protectionism, for example, has been greatly different in Sweden, on the one hand, than in Argentina, on the other. This difference must be due, in part, to the difference in the economic professions in the two countries.

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<sup>1</sup> I examined this issue somewhat less superficially in a talk in Stockholm in 1984 organized by PKbanken.

<sup>2</sup> See my paper on "How Ideas Affect Societies" in *Ideas, Interests & Consequences*, (London: Institute of Economic Affairs, 1989), and also reprinted in the *LSE Quarterly*, 3:4 Winter 1989, pp. 279-304.

## ***Encompassing Organizations***

Another factor that probably reduces the amount of implicit redistribution in Sweden is the large role that what I call "encompassing" organizations have played, at least at times. Suppose that an organization encompasses a large part of the income-earning capacity of a country; its constituents earn, say, 50 percent of the nation's GDP. Such an organization, *if* it truly furthers the interests of its clients, will act very differently from the narrow coalition considered in Chapter 5 that represented only 1 percent of the income-earning capacity of a country. If the constituents of the organization get half of the benefit of anything it does to increase the prosperity of a country, that will often be enough to give the organization an incentive to do something to make the country more efficient and innovative. Such an organization, if it optimally serves its clients, will also not seek any redistributions for its clients that entail a social loss that is large in relation to the amount redistributed. If the clients of an organization get half of the Swedish GDP, they will on average bear half of the social loss from any redistribution to themselves. Their organization, if it represents them rationally, will then arrange any redistributions to them in ways that hurt the society as little as possible, and it will also stop demanding redistribution whenever the social costs of a redistribution come to be twice as large as the amount that is redistributed. Unlike the distributional coalitions considered in the Chapter 5, encompassing organizations have an incentive to seek only *efficient* redistributions, and bargaining costs between any pair of encompassing organizations may not be prohibitively high. Thus the theory of efficient redistribution may, at times, apply to some extent in societies with encompassing organizations.

Encompassing organizations have been relatively more important in Sweden than in most other countries. The LO (especially in the 1950s and early 1960s, but less so now) has represented a large proportion of the whole organized work force. To some extent, it has been linked with the Social Democratic Party, which strives to control the government by itself and thereby represent a majority of the electorate, and is accordingly an encompassing organization. The Swedish Employers' Federation represents most of the business in the country and is similarly an encompassing organization. In *The Rise and Decline of Nations*, I argued, in a cautious and carefully qualified way, that maybe some of the economic growth of Sweden and of other countries with encompassing organizations, such as Austria and Norway, could be attributed to the unusually encompassing character of their organizations. In subsequent publications, I have examined the strong forces that, over the long run, can make encompassing organizations break down, or fail to act in ways that serve their clients' aggregate interests, and emphasized again the dangers of considering encompassing organizations as an ideal or reliable solution to the problem of institutional sclerosis.<sup>3</sup> I also urged more research on the matter.

Some extremely interesting research along these lines has in fact been done. For

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<sup>3</sup> "An Appreciation of the Tests and Criticisms," *Scandinavian Political Studies* (March 1986)

example, in independent articles on unemployment and macroeconomic stability, Lars Calmfors and John Driffill,<sup>4</sup> on the one hand, and Bradford DeLong and Lars Jonung,<sup>5</sup> on the other, have found that countries with encompassing organizations and countries with decentralized, competitive arrangements tended to have lower unemployment rates than countries with the in-between arrangement of a dense network of narrow distributional coalitions. While also making other contributions, these papers greatly extend the theory in *Rise and Decline* and they are in general accord with the argument that has been used in this essay.<sup>6</sup> Similarly, in another study Bernhard Heitger found that growth rates were also higher in countries that had encompassing organizations or relatively weak distributional coalitions and were lower in countries with strong but narrow distributional coalitions.<sup>7</sup>

One likely possibility is that, as the Calmfors-Driffill, DeLong-Jonung, and Bernhard Heitger papers appear to suggest, Sweden is doing as well as it is, in part, because it has had relatively more encompassing organizations than the English-speaking countries, for example. I am, however, anxious not to push this argument too far or to oversell the idea of encompassing organizations. Thus I hope that any readers who are inclined to think that encompassing organizations are a reliable solution will examine the extensive argument I have offered about how encompassing organizations tend to break down over time or come to be decisively influenced by small subsets or coalitions of their own membership.<sup>8</sup>

### ***Factors Lowering the Costs of Explicit Redistributions***

While implicit redistributions are much more important and more damaging to economic performance than has previously been understood, there are also reasons why explicit

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<sup>4</sup> In "Centralization and Wage Bargaining," *Economic Policy* (April 1988), pp. 14-61.

<sup>5</sup> In "Hysteresis, the Corridor, and the Political Economy of Unemployment, 1955-1986" (forthcoming). For a fuller analysis of the Calmfors-Driffill and DeLong-Jonung papers and for a fuller statement and wider tests on how the more general theory at issue helps explain unemployment and macroeconomic performance, see Michael Kendix and Mancur Olson, "Changing Unemployment Rates in Europe and the USA: Institutional Structure and Regional Variation," in *Labour Relations and Economic Performance* (London: MacMillan Press Ltd, 1990), pp. 40-67.

<sup>6</sup> In one respect, the technical features of the Calmfors-Driffill model are somewhat different from the argument in *Rise and Decline*, since they assume labor cartelization at the small enterprise level as their decentralized or competitive polar case, rather than completely competitive arrangements. But in their model the cartelistic power of workers in these enterprise unions is sharply limited by the competition from firms producing close substitutes, so that in fact their argument is, as they point out, similar in spirit to mine.

<sup>7</sup> "Corporatism, Technological Gaps, and Growth in OECD Countries," *Weltwirtschaftliches Archiv* (1987).

<sup>8</sup> In "An Appreciation..." cited above.

redistributions are, sometimes, less damaging to economic performance than might be supposed at first glance. Some of these reasons are merely the obverse of the arguments about implicit redistribution, and I shall set them out before going on to those that are entirely different.

As we saw earlier, there are fundamental reasons why such scattered groups as the poor are not able to act collectively and they are not organized anywhere. Public programs for low-income people are, accordingly, *not* due to lobbying or other organized action by the recipients of the transfers, but are rather mainly the result of the sympathy and egalitarian sentiments of the electorate and the political leaders they have elected. *Since popular moral, sympathetic, and ideological motives mainly inspire income transfers to low-income people, there is usually no desire to conceal these transfers;* political leaders may even point to them with moral satisfaction. Egalitarian welfare-state transfers to low-income people (and to the aged, handicapped, and so on) are, therefore, open transfers out of the public treasury.

This means that redistributions inspired by the moral judgments of the electorate need not (and often do not) involve any monopolization or protectionism, such as coalitional redistributions typically entail. Nor do they entail conditions on government subsidies designed to create the impression they are intended to serve some broad social purpose - they already reflect the moral purposes of the electorate. As a result, the extra social costs of monopolization, of protectionism, and of conditions on government grants that appear to rationalize them are usually not a serious problem with redistributions that arise because of the sympathy of the electorate.

There are also totally different reasons why the explicit redistributions inspired by the moral concern of the citizenry sometimes have lower costs than implicit redistributions. For one thing, the prototypical morally inspired redistributions are to the poor, the aged, the ill, the handicapped, and fatherless children. On average, the recipients of those redistributions inspired by sympathy are, after all, less productive than those who are well off - *the same traits, such as age or handicaps, that tend to provide entitlement to welfare-state transfers, usually also imply low productivity.* Some recipients of transfers would not have been working anyway, and transfers to such people need not have any significant deadweight loss beyond that of the taxation that is needed to pay for the transfer. In most cases, the people who are most productive and whose skills and resources are also currently prized in the society are not, at the same time, poor.

A society can transfer funds to individuals who would not have been working in any case or to individuals who would, in the absence of welfare payments, be domestic servants or gardeners, yet remain dynamic and productive. But it cannot misdirect the energies of its best workers, managers, professionals, entrepreneurs, or corporations without serious losses. It is mainly the former that are the objects of the sympathy of the electorate, and mainly the latter that are able to overcome the difficulties of collective action.

The recipients of transfers inspired by sympathy will, moreover, normally not be

major users of intermediate goods and accessory inputs in the way many beneficiaries of distributional coalitions are. To obtain an increase in *net* income through redistribution of a hundred million crowns, the members of a coalition will normally have to obtain or carry out a policy that misallocates intermediate goods and complementary resources, so the firms or workers in an industry will obtain only a part of any higher prices or other benefits their organized power brings about. Society may need to spend many times as much as a hundred million crowns to increase the net income of the organized group by this amount. By contrast, when there is, through the sympathy of the electorate, a desire to shift a hundred million crowns to the poor, there need be no misallocation of intermediate goods and the like, for the poor do not normally control productive processes that use a lot of accessory resources, and the transfer to them is likely to be a fairly straightforward transfer.

The limited involvement of the poor in the productive process also means that aid to them does not have much impact on the innovation that is the main source of economic growth. As Chapter 5 argued, the regulation and complex agreements that are associated with implicit redistributions delay innovation and thus affect the rate of increase of productivity as well as the static allocation of resources. By contrast, explicit redistributions to low-income people usually affect only the existing allocation of resources, rather than the processes by which innovation take place.

Yet another factor tends to make the losses in efficiency and dynamism from egalitarian-inspired redistribution less than those from redistributions obtained through the capacity to lobby or to cartelize. Although the matter is complicated by such factors as the organized power of those who administer public programs for the poor, there is still a sense in which these explicit transfers are limited by the preferences of the electorate. These transfers come out of the public treasury and their magnitude is accordingly known, and this means that in the long run they cannot be larger than some majority in the electorate is willing to accept. There is no equivalent constraint on redistributions whose magnitude and purpose are obscured.

Although rational ignorance always works against efficiency in redistribution, the theory of efficient redistribution is not so far off the mark for explicit redistributions. Certainly, Gary Becker's contention that the political opposition to a redistribution rises as its social costs increases is true for explicit redistributions. Since the costs of explicit transfers to low-income people are relatively transparent, we should expect that the opposition to them should increase as their social costs rise. This appears to have happened in many countries: as the size and excess burden of the welfare state has increased, so has the opposition to its growth. It is even possible that the design of programs to aid poor people will improve over time and that societies will, as experience and insight accumulates, converge on levels of explicit transfers that take full account of both the deadweight losses from such programs and their moral worth.



## ***A Recapitulation***

Let us recapitulate the argument of this essay and try explicitly to answer the second question - Why isn't Sweden worse off? My first question, about why Sweden is not even richer, has a standard answer: that Sweden's unmatched degree of egalitarianism and its uniquely large public sector impair the incentives to work, save, and allocate resources to their most productive uses. There is no standard answer to the second question. Yet we must be cautious about saying anything very general about the Swedish economy until we have an answer to the second question.

Although the performance of the Swedish economy looks much less impressive now than it did at the end of the 1960s, Sweden's per capita income still puts it in the top group of countries. The Swedish economy has outperformed not only the underdeveloped and Eastern European economies, but also some economies that were once ahead of it. Even on the lowest possible estimate of Sweden's performance, its economy is ahead of Argentina's, Ireland's, and Britain's, but all these societies have had less egalitarian redistribution and relatively smaller public sectors than Sweden. The puzzle is heightened by the fact that there is no very strong tendency for the countries or historical periods with the largest welfare states to grow more slowly than those with less redistribution to low-income people.

The only serious and intellectually honest way to tackle the second question is with a realization that the familiar answer to the first question is largely true. The reasons for believing that individuals respond to incentives in the way economists predict - and that tax and subsidy payments as large as those in Sweden must bring deadweight losses - are compelling. There is further evidence of the decisive importance of the familiar economic analysis of incentives in the data and historical information on international trade that was presented in Chapter 2. This chapter showed that trade in manufactures in smaller countries provides impressive evidence about the impact of protection: no small country with really high protection of manufactures has been able to develop an internationally competitive manufacturing sector. The great quantitative significance of trade policy is also made clear by the pattern of rapid growth after there has been a great increase in the size of jurisdictions and trading areas.

Taken together, the unequivocal data on protectionism and economic performance and the ambiguous data on the size of the welfare state and growth are puzzling. Why does the distortion of incentives through trade policy evidently have so much more quantitative significance than the distortion of incentives through welfare state redistributions?

At first glance, the theory of "efficient redistribution" might seem to explain why Sweden and other large welfare states are doing as well as they are. This theory holds that, if the dead-weight losses from any kind of redistribution rise, the political opposition to the redistribution will also rise, and ultimately to the point where further redistribution will cease. The social losses from redistribution are accordingly usually

fairly small. Some versions of the theory of efficient redistribution assume that the bargaining between the groups with conflicting interests about a redistribution will continue until the joint gains of the groups in question are maximized so that the society is fully efficient.

The theory of efficient redistribution as it stands is not satisfactory, in part because it fails to distinguish between two different types of redistributions of income. There are not only the explicit redistributions that are at the center of debates about the welfare state, but also implicit redistributions. These implicit redistributions occur when a government program or other collective action changes the distribution of income without increasing the aggregate real income of the society, but the policy is rationalized by alleged benefits to the nation as a whole or to groups other than the group that seeks the redistribution. For example, protectionist measures or restrictions on competition that are represented as strengthening a national economy, but actually change the distribution of income in favor of the group that seeks the protection or restriction of competition, are implicit redistributions.

The social loss from redistributions of income arises in large part from the criteria or conditions that are attached to or implicit in them. If an individual in an efficient economy with competitive markets is given cash with no strings attached, the incentives of the recipient are not impaired, because he or she continues to have an incentive to allocate all resources to their most productive uses. By contrast, a redistribution that is officially restricted to those in some industry, occupation, or locality - or that takes the form of a change in relative prices - distorts the incentives facing the recipients of the redistribution and adds to social costs.

The redistributions that actually occur, and the ways they are carried out in practice, depend dramatically on "rational ignorance" - the fact that the typical citizen does not serve his or her interests by spending a lot of time studying public affairs and therefore is relatively uninformed about public policy. Rational ignorance makes it possible for an organized interest to obtain a redistribution that the majority of the electorate would not have tolerated had it been fully informed. Accordingly, a redistribution that can be made to appear to be a measure that actually strengthens a society, or that is so inconspicuous that it is not noticed by the average voter, can be politically viable, even if the recipients of the redistribution are relatively well off people who would not have been able to persuade the electorate to give them a transfer on altruistic grounds.

The capacity for collective action is found mainly in established groups and is stronger at upper than at lower income levels. This is because collective action is possible only for groups that have small numbers, like the large firms in concentrated industries, or have access to "selective incentives" that are usually available only to insiders and relatively well established groups. Those groups at the bottom of society, such as the poor and the unemployed, and some other groups, such as consumers and taxpayers, are virtually never able to act collectively.

This implies that most of those groups that have the capacity to act collectively

are not in a position to obtain explicit redistributions on grounds of need. They must instead use their power to get implicit redistributions. Because of rational ignorance, they can often get substantial redistributions through actions and policies that do not appear to be redistributive and that appear to serve the society as a whole, or are so inconspicuous that they are not noticed by a rationally ignorant electorate. Organized interests accordingly prefer redistributions that are *not* unconditional cash transfers, but rather embody conditions that make them appear to have a general social purpose. Ideally, a coalition wants policies that change relative prices in its favor, and that do not involve cash transfers from the government budget. Coalitions that represent only a tiny part of the income-earning capacity of a society have an incentive to seek such redistributions even if the social costs are large multiples of the amount they win in the distributional struggle.

The fact that many groups are not able to organize for collective action means that in most cases the losers from redistributions are not able to act collectively. It follows that there is usually little or no bargaining among gainers and losers from redistributions and thus little or no tendency for bargaining to reduce the social costs of redistribution. This factor, and the incentive for organized groups to choose untransparent and inherently conditional redistributions with relatively high social costs, means that the theory of efficient redistributions is wrong for implicit redistributions.

Societies with a high density of narrow distributional coalitions have lower income levels and growth rates than would otherwise be expected. Small countries with high protection of manufactures have particularly high levels of implicit redistribution, since the concentrated industries behind protectionist barriers are able to fix prices with relative ease. Cartelized labor forces in these industries can also organize redistributions to themselves with relatively little constraint. This helps to explain the strong findings on international trade in Chapter 2. The aforementioned facts, along with a number of quantitative studies of the social costs of particular implicit redistributions that have been done by other economists, support the theory offered in this book.

Although Sweden undoubtedly loses a good deal from implicit redistribution, there are many reasons for thinking that it probably does not lose as much from this as some other countries do. Sweden's relatively low level of protection of manufactures, its relatively high level of economic understanding, and its "encompassing" organizations suggest that implicit redistributions may not escape social control quite so much in Sweden as in some other countries.

Usually, implicit redistributions delay innovations more and have higher overall social costs than explicit redistributions. This is partly because implicit redistributions exploit rational ignorance and cannot be transparent, and therefore entail conditions or criteria that restrict the redistribution to those in some industry or activity, which in turn distort the allocation of resources. The lack of transparency of implicit redistributions also means that they are less likely than explicit redistributions to be curtailed when their social costs get out of hand. In contrast, altruistically motivated explicit redistributions often involve some special factors that limit their social costs: the recipients are

generally not the most productive people in the society, so the misallocation of their time involves less social loss; they normally do not control any significant resource beyond their own time, so intermediate goods and auxiliary factors are usually not misallocated; their limited involvement in the productive process implies that the aid to them does not normally affect the rate of innovation, which is the main determinant of the rate of economic growth.

Although a final answer to the second question must await further research, I propose a tentative answer designed to stimulate the thinking and research of those who know much more than I do about Sweden. Sweden may well lose somewhat more from explicit redistribution than most other countries, but explicit redistribution does not have nearly as much importance for economic performance as might be supposed from the ideological debates. At least in many countries, implicit redistribution is a more important influence on the economy. While Sweden's losses from implicit redistribution are no doubt substantial, there is no reason to suppose they are as high as in some other countries. Since the social losses from implicit redistributions are often much greater than those from explicit redistributions, the economies that have exceptionally high levels of implicit redistribution perform relatively badly. Sweden is therefore able, in spite of its high level of explicit redistribution, to surpass or at least match these countries. As I see it, that is probably why Sweden is not, relatively speaking, worse off.

An auxiliary finding of the argument here is that a society can, if it has good policies generally and avoids redistributions that have no moral justification, provide decently for its poor, yet also be a dynamic and prosperous society.

### ***Too Much of A Good Thing is Bad: Nonlinearities and Lags***

I am very concerned that my argument should be balanced, fair-minded, and useful to thoughtful people of all political persuasions. Thus I am worried about the possibility that the argument in this book will be pushed too far. This danger can be seen most starkly by imagining that the moral concern for those of below-average income were to go to the point that each person with a below-average income would be given a transfer sufficient to bring him or her to the average level of income. If no one has a below-average income, no one can have an above-average income either: this would imply a system of taxes and transfers that would eliminate all inequality of incomes. And this, of course, would eliminate *all* incentive to earn income.

This extreme case is useful in reminding us that the social loss from redistributions of income inspired by egalitarian motives is strikingly dependent on how much income is redistributed. The arguments and evidence earlier in this essay indicate that an open, competitive society can do a great deal to alleviate the misfortunes of the poor without losing its dynamism. The sclerosis in the Western societies is mainly not the result of efforts to relieve destitution, but rather of other causes.

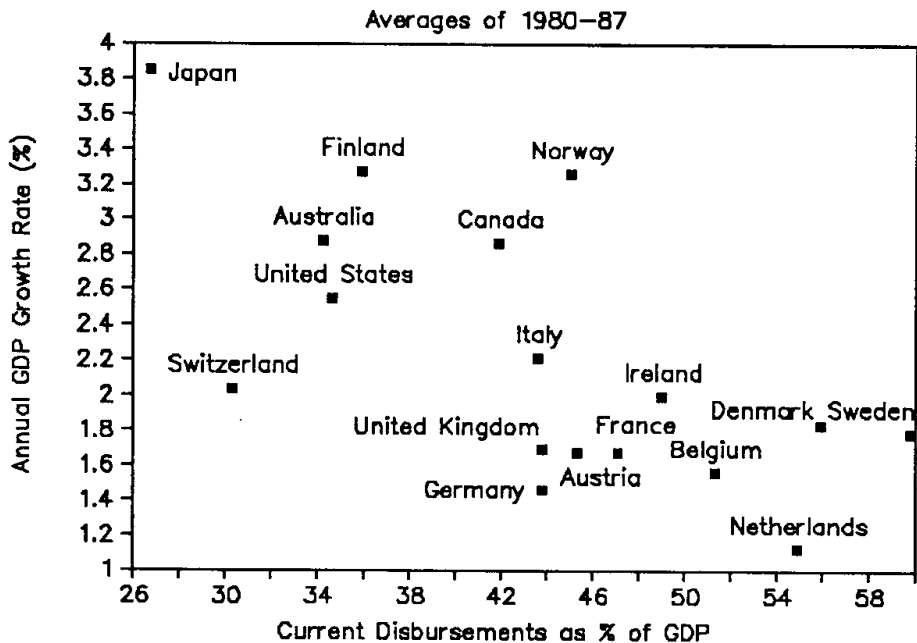
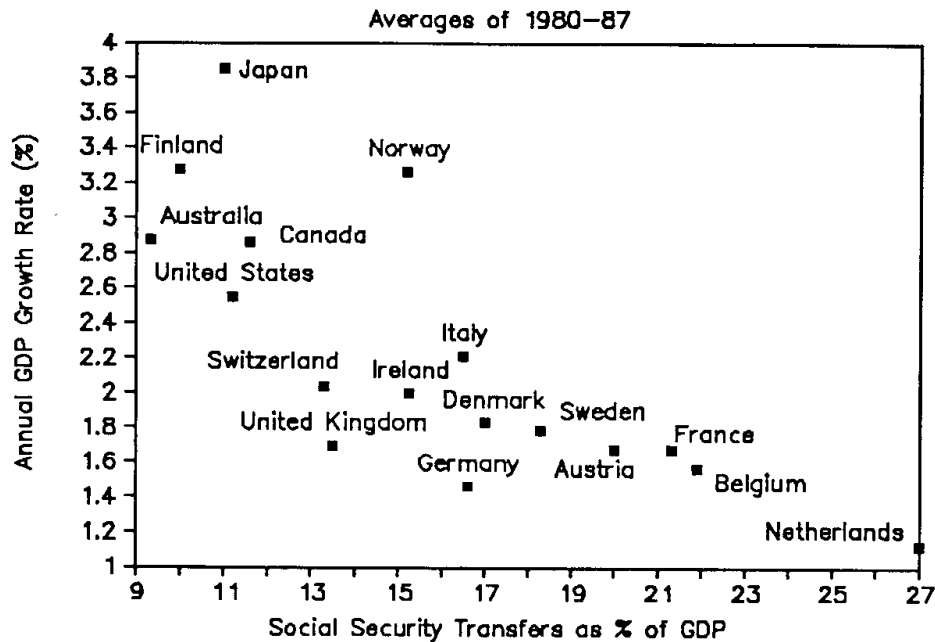
Yet, after some point, *additional* egalitarian redistribution must bring *disproportionately* large costs to society. When transfers are sufficiently large, taxes must be so high that their excess burdens and their adverse effects on risk-taking and innovation are overwhelming. Moreover, the condition inherent in egalitarian redistribution - that the recipient lose entitlement to the transfer if he or she succeeds in earning a good income - ensures that the social costs of the distribution of the transfers must rise nonlinearly when redistribution comes close to the point of eliminating all inequalities. There need be virtually no loss of dynamism in a society from helping the poorest 5 percent: their misfortunes and disabilities would have limited the extent of their production and innovation in any case, and (if other things are right) there will be a cornucopia of output from the remaining 95 percent. But if a society tries through transfers to bring even those who are 5 percent below the average income closer to the average, all incomes must be about the same and nearly all of the incentive to produce and innovate will have been taken away. As society enters anything resembling this latter range, increased transfers must lead to wildly disproportionate losses of efficiency and innovation.

Earlier in this book I presented some merely illustrative data to warn readers against the commonplace assumption that the large growth of the welfare state overwhelms other factors influencing economic performance. Lest data that were offered to motivate inquiry be interpreted recklessly or in a one-sided way, I present some further data that point in the opposite direction in Figure 4 and Table 5. From the figures on the size of government and economic growth in the last few years, it appears that the countries with larger public sectors have tended to grow more slowly than those with smaller public sectors. These further data, coming as they do from only a few years and being insufficient in other ways as well, *establish* nothing, but they do raise a useful question. They alert us to the *possibility* that redistribution could be having greater social costs in more recent times, when it has been pushed a good bit farther than in the 1950s and early 1960s.

What about the egalitarian redistributions in Sweden today? Are they more or less explained by my earlier argument, showing that egalitarian redistributions can have social costs that are fairly small, especially in comparison to those arising from the redistributions obtained by well-established and relatively well-off organized interests? Or have they risen into the range where the social costs are absurdly disproportionate?

This is a not a question that can be answered from afar, and it is in any case a matter for Swedes to decide. Moreover, to answer this question correctly one would have to go into many important aspects of the matter that I have not even touched on here. In general, these other aspects of the matter are dealt with very well in the impressive Swedish literature on the welfare state, so there was no reason for me to go into them here. The purpose of the present essay is not to settle ancient controversies or to summarize the existing literature, but rather to introduce some fresh perspectives that may enable people with a detailed knowledge of Sweden to get a *better view of both sides of the matter*.

Figure 4



Given the nonlinearity that has been described, we can also see why the argument about time lags discussed earlier in this essay was too simple. We can be reasonably certain that most of the adverse effects of the levels of egalitarian redistribution in Sweden in the 1930s or 1950s have already been felt. But it is too early to know what the full effects of the higher redistributions of the late 1970s and the 1980s will be.

Table 5: Average Government Size and GDP Growth, 1980-87 (percent)

	Annual GDP Growth	Government consumption	Social Security Transfers	Government Expenditure	Current Disbursement	Total outlays
Australia	2.87	18.5	9.3a	27.8	34.2a	37.3a
Austria	1.67	18.7	20.0	38.7	45.3	51.1
Belgium	1.56	17.5	21.9	39.4	51.3	53.9
Canada	2.86	20.0	11.6	31.6	41.9	45.2
Denmark	1.83	26.4	17.0	43.4	55.9	59.1
Finland	3.27	19.5	10.0	29.5	35.9	39.8
France	1.67	19.1	21.3	40.4	47.1	50.6
Ireland	2.00	19.0	15.3a	34.3	49.0a	54.0a
Italy	2.21	16.1	16.5	32.6	43.6	48.2
Japan	3.85	9.8	11.0	20.8	26.7	33.3
Netherlands	1.12	17.0	27.0	44.0	54.9	60.2
Norway	3.26	19.3	15.2	34.5	45.0	48.3
Sweden	1.79	28.1	18.3	46.4	59.8	63.8
Switzerland	2.04	13.1	13.3	26.4	30.3	30.3
United Kingdom	1.70	21.4	13.5a	34.9	43.8a	46.9a
United States	2.55	18.2	11.2	29.4	34.6	35.9
West Germany	1.46	20.1	16.6	36.7	43.8	48.0

Note: For Definitions and Sources, see Table 1. a. 1980-86.

### ***How Bright are the Northern Lights?***

I hope this essay has succeeded in conveying my conviction that a society can, if its policies and institutions are intelligent, prevent destitution and even make fairly generous provision for its least fortunate citizens, yet still remain a prosperous and dynamic society. If a society opens its markets to imports and avoids special-interest legislation, cartelization, and collusion, it can be innovative and prosperous even while it significantly alleviates the privations of its poorer citizens. At least to a degree, this same conviction was part of the inspiration behind the Swedish welfare state. Thus I believe there really are Northern Lights. They are beautiful. They can also give societies a rough sense of direction. But they are not bright or stable enough to save a society, if it

rushes far ahead without taking along any further sources of light, from stumbling into catastrophe.