THE SCANDINAVIAN WELFARE MODEL AND THE ROLE OF CIVIC CAPITAL: PAST EXPERIENCE AND FUTURE CHALLENGES

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Abstract: This paper introduces the concept of civic capital in explaining why the Scandinavian welfare model has been so successful in generating economic performance during the recent decades. Civic capital splits into several measurable factors of which trust, scope of morality and fairness are dealt with in more details in this paper. The recent research shows that the above factors have influences on productivity, output per capita and the level and complexity of regulation, and that the above factors are also associated to the good economic performance of the Scandinavian welfare model.

Keywords: civic capital; Scandinavia; economic performance.

1 Introduction

As, for example van der Ploeg (2004) and Molana and Montagna (2010) suggest, conventional wisdom is that high taxes and generous welfare states are harmful for the economy. However, the Scandinavian high tax-rate welfare economies[1], that is, countries like Denmark, Finland, Norway and Sweden, have been successful in economic development during the past decades. Consequently, the standard of living is high in these countries and the citizens' happiness scores in many surveys are among the highest. Beyond doubt, a view departing from the conventional wisdom is required to fully understand the success of the Scandinavian model and to identify the critical points in the future development of the model.

In this paper, we broaden the mainstream economics view to see how certain factors in a country's social infrastructure influence on the economic performance of

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1 The Scandinavian welfare model refers to an economy having a high tax rate and a generous welfare system. In practice, we here refer to Denmark, Finland, Norway and Sweden as Scandinavian welfare economies, that is, representative economies of the Scandinavian welfare model.

the country. The term social infrastructure here refers to the institutions and government policies and regulation which make up the environment where individuals accumulate human capital and where firms accumulate physical capital and produce goods (HALL; JONES, 1999). Hence, social infrastructure refers to factors which explain, first, the accumulation of capital and the level of productivity and, second, the growth of output per worker.

The key concept in our analysis is civic capital. By this, we mean shared beliefs and values that help individuals and groups coordinate and cooperate successfully (GUISO; SAPIENZA; ZINGALES, 2011). Civic capital also fleshes on the bones of social infrastructure by helping to understand how cooperation has been a successful force in fostering economic development in spite of the fact, as Bowles and Gintis (2011) note, that selfishness is a strong motivating power. From this perspective, the Scandinavian Welfare Model is, as stated by Fong, Bowles and Gintis (2006, p. 1439), “a remarkable human achievement” and “the most significant case in human history of a voluntary egalitarian redistribution of income among strangers”.

Thus, civic capital is revealed in the values and beliefs people have. The beliefs and values determine how individuals and groups react to the welfare state and to law and regulation and how they contribute to the steering of the development of both the welfare state and regulation. Prior research suggests that two equilibria are essential. First, as argued by Alesina and Angeletos (2005), the welfare model is based on the citizen’s belief that one’s success in life does not depend on hard work but rather on luck. Second, the model by Aghion et al. (2005, p. 960) explains that social trust has a driving role in balancing markets and regulation as means to support economic prosperity. In particular, trust makes it possible to reduce and simplify regulation without an increase in corruption and market malfunction.

The rest of the paper proceeds as follows. The second section provides an introduction to civic capital and to the ways it has been measured in the literature. In the third section, we analyze how citizens’ perception of the role of hard work and luck as determinants of their economic success may create a fairness standard which explains their preferences for redistribution. In section four, we elaborate the question of the interplay of civic capital versus regulation. Finally, section five concludes and points to some challenges of the Scandinavian welfare model.

2 Civic capital

In their attempt to make progress in economists’ analysis of the effect of culture, values and beliefs on economic development that Guiso, Sapienza and Zingales (2006a) employ the umbrella concept of social capital but want to avoid its ambiguities by introducing the notion of civic capital. Accordingly, civic capital refers to “those persistent and shared beliefs and values that help a group overcome the free rider problem in the pursuit of socially valuable activities” (GUISO; SAPIENZA; ZINGALES, 2006a, p. 418). Thus, values and beliefs of civic capital foster cooperation and coordination and help individuals and groups in navigating through various collective action situations.

A key factor in civic capital is trust. By this, we mean that in a situation where actors A and B interact, actor A trusts on actor B if A believes with high probability that B will keep her promise or that B behaves in accordance with reasonable expectations based on known and shared social norms, regulatory rules or law. There are several operational definitions of trust (DASGUPTA, 2009), but here we employ the one provided by Guiso, Sapienza and Zingales (2006a) and originally suggested by Gambetta (2000). Accordingly, trust is a belief concerning the probability of the other (unknown) person's action being cooperative enough for us to act cooperatively too. This probabilistic definition is cardinal – that is, the average value of trust for a community is meaningful and makes community comparisons possible. In addition, as included in almost all definitions of trust, higher value of trust proxies higher tendency for cooperation.

Another key factor in civic capital is the scope of morality – namely, the breadth of the circle within which common social norms and rules are complied. If the circle is concise, we can expect that non-compliant and opportunistic behavior is more permissive with partners outside the circle than with partners within the circle (WILLIAMSON; MATHERS, 2011). Accordingly, a broader scope of morality should lead to better economic performance (WILLIAMSON; MATHERS, 2011). To combine trust and the scope of morality, Tabellini (2010) argues that low level of trust and the narrow scope of morality are typical in hierarchical societies where:

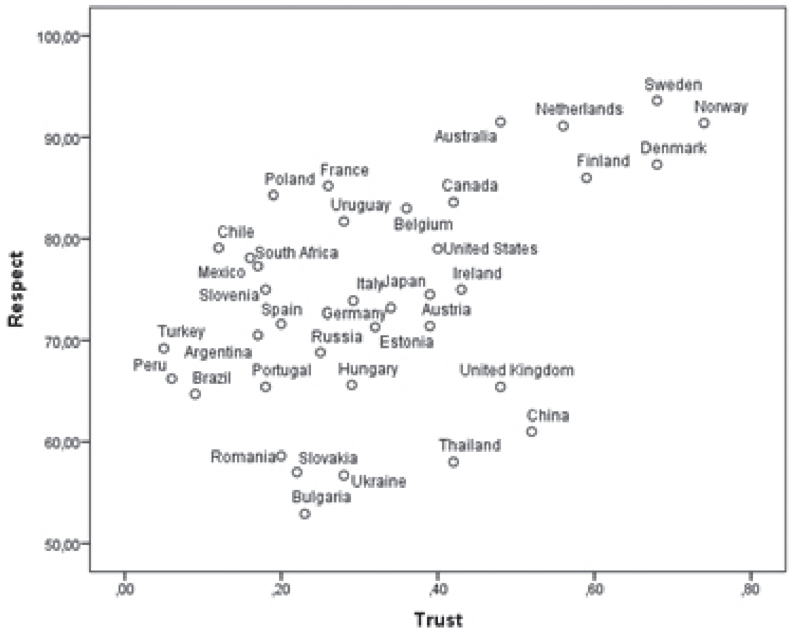
> Good behavior is deemed to result from coercion, not from internalization of the values of society. Hence, the role of the state is to force citizens to behave well. Of course, such coercive cultural environments stifle individual initiative and cooperation within a group, and can hurt growth and development.

In summary, the sequence of influences is assumed to go from a hierarchical social structure to a low level of trust and a limited scope of morality and, then, from a low level of trust and a limited scope of morality to coercive and complex regulation. Finally, coercive and complex regulation is harmful for initiative and cooperation and, in addition, for accumulation of capital and growth of productivity.

To better understand these key factors in civic capital, we follow the conventions of this research tradition in measuring trust and the scope of morality with data provided by the World Values Survey (WVS). In this survey, the following question is used to measure trust: "Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people?" Two alternative responses are available: "Most people can be trusted" and "Can't be too careful". The country-level percentage of the affirmative responses is then used as a variable indicating the level of trust in the country. This general trust is found to be typically high in the Scandinavian countries and low in the Mediterranean, Latin American and post-socialist transition countries. In addition, such trust has a positive correlation with many economic indicators, such as GDP per capita and GDP per worker (KNACK; KEEFER, 1997, p. 112). The validity of the WVS-question in measuring trust has been heavily debated by several authors, such as Sapienza, Toldra and Zingales (2013), Uslaner (2008), Beugelsdijk (2008), Nannestad (2008) and Dasgupta (2009). However, recent research among experimental economists shows that the WVS-question is a valid measure of general trust (JOHNSON; MISLIN, 2011). Nevertheless, there is still need to improve the measure as seen in Naef and Schupp (2004).

In measuring the scope of morality, we use the so-called respect variable which is constructed on one of the eleven items in the WVS-question related to values the respondents consider to be especially important in children's education at home. One of the values is "tolerance and respect for other people" which is taken to reflect the scope of morality (TABELLINI, 2010, p. 687). Also the respect variable varies between zero and one.

Figure 1. Trust and respect



Fonte: Elaborated by the autors.

Figure 1 shows how trust and respect vary across countries. The data is based on WVS waves 4 (conducted in 1999-2004) and wave 5 (conducted in 2005-2009). The figure suggests that the Scandinavian welfare economies form a group of their own where trust is at a high level and the scope of morality is broad. This implies that, in these countries, cooperation is fostered and put into practice with low transaction costs and in an environment where regulatory complexity is low.

3 Fairness and the support of redistribution

In conventional economic theory the explanation for the support of income redistribution is based on the median voter theory (DOWNS, 1957; CONGLETON, 2003). According to the theory, the middle-class drives the politically determined part of a country's fiscal policy. Recent research has, however, undermined the view. For example, Scervini (2012) shows that the middle-class receives only a negligible gain from redistribution.

Analyses by Alesina and Angeletos (2005) and Fong, Bowles and Gintis (2006) show that many social norms and values influence on the demand of income redistribution among citizens. Among the factors often neglected by mainstream economists are fairness, work ethics and reciprocity. Alesina and Angeletos (2005, p. 962) show, that the attitude towards the role of 'hard work' versus 'luck' as a driver of success in life has an influence on the demand for redistribution. An interesting result by Fong, Bowles and Gintis (2006) is that the support of the welfare state reflects the norm of reciprocity – that is, people are willing to help others who are in need due to bad luck rather than their own fault.

Both the question of 'hard work' versus 'luck' and the norm of reciprocity are associated with fairness concerns or rules. First, as Alesina and Angeletos (2005, p. 974) state, inequality which is generated by 'hard work' is considered fair, whereas the inequality generated by 'luck' is regarded as unfair. Second, the appearance of the reciprocity norm in redistribution contexts itself implies that people consider it fair to help those who are in need due to bad luck and who are active in their endeavor to improve their situation.

Alesina and Angeletos (2005, p. 974) explain their model of two macroeconomic equilibria in the following way. In the first equilibrium, people see that a norm of 'hard work' is a condition of individual success and that also income differences are mainly due to working hard. These views are accompanied with preferences for low redistribution. In the second equilibrium, 'luck' rather than hard work is a relatively stronger condition for individual success. Consequently, 'luck' is seen in this equilibrium as a strong determinant of income differences. These views are associated with preferences for high redistribution. Alesina and Angeletos (2005, p. 974) call the first case as a US-style equilibrium and the second one as a European-style equilibrium[2].

Empirical cross-country evidence from surveys, such as the World Values Survey, predominantly support the argument that those who believe that success is a matter of luck are much more supportive of redistribution than are the others (ALESINA; ANGELETOS, 2005, p. 964). Tammi (2013) made comparisons between Spain, Sweden and the USA and found that the belief that success depends on luck is positively correlated with the support of redistribution in the case of Sweden. The correlation is negative in the case of the USA and negative but non-significant in the case of Spain. This hypothesizes that the European-style equilibrium in Alesina and Angeletos's model may describe

[2] An account of the historical origin of this difference is in Alesina, Glaeser and Sacredote (2001).

the Scandinavian welfare economies rather than South-European and East-European countries. In addition, de Figueiredo (2012) suggests that Latin American countries fall outside the model since these economies may lack the fairness rule based on the role 'hard work' or 'luck' in generating income differences.

Fong, Bowles and Gintis (2007, p. 1441) study the role of reciprocity in supporting a welfare state. First, they define what they mean with the concept of 'strong reciprocity'. According to them (emphasis added):

> Strong reciprocity is *a propensity to* cooperate and *share with others similarly disposed, even at personal cost*, and *a willingness to punish those who violate* cooperative and other *social norms*, even when punishing is personally costly and cannot be expected to entail net personal gains in the future.

In other words, strong reciprocity can take either the form of: 1. willingness to redistribute a portion of one's own resources to others on the condition that the others fulfill definite social norms, or 2. unwillingness to redistribute to those who don't fulfill these norms. We term this propensity as *conditional willingness to redistribute* one's resources. Fong, Bowles and Gintis (2007), then, interpret that one's willingness to redistribute depends on one's knowledge or perception of the beneficiary's character. They also find, on the basis of the World Values Survey data, that those people who think that poverty is caused by laziness give a weaker support to redistributive policies. In comparing Spain, Sweden and the USA, Tammi (2013) found that the same also applies to the USA and Sweden but not to Spain.

To sum up, we have identified two factors that are suggested to have an influence on the support of income redistribution. One is social acceptability of those who are the beneficiaries of redistribution. The other is the way of thinking of what is the major determinant of economic success in the economic system people live in. We also noticed that there is empirical support for the views, albeit different data and data-sets may help to specify how these factors operate in different countries and in different cultures.

4 Trust, regulation and corruption

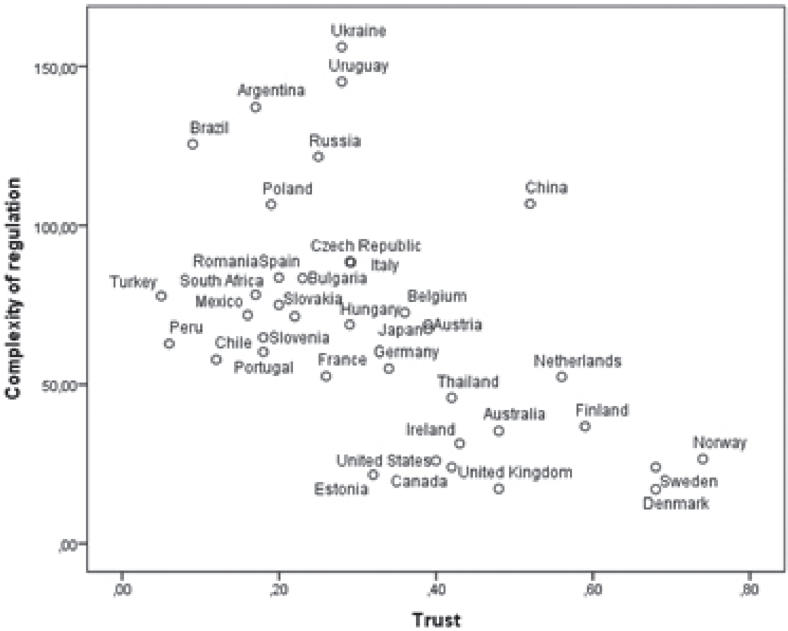
The third line of research on civic capital and its relation to economy poses the question of a strong correlation between distrust and the level of regulation. Aghion et al. (2010) found that civic capital is a substitute of regulation and that strong distrust generates demand for regulation. Pitlik and Kouba (2014) extend this research by showing that high trust to state actors is positively associated with the support of government intervention conditional to distrust in major companies.

The model by Aghion et al. (2010) assumes that people learn civicness in families and in schools. In their model, those who are uncivic (and distrust others) create negative externalities on others. These externalities can present themselves in forms such as pollution, high transaction costs or high contracting costs. On the other hand, those who are civic do not create these externalities. In the case that uncivicness dominates in a community, the community turns to increased regulation to restrict the negative externalities. In addition, since uncivicness dominates, also corruption is likely to increase among government officials who implement regulation.

The analysis by Aghion et al. (2010) also provides a model of belief justification. Namely, if an individual thinks she lives in a civic community, she expects low levels of externalities, regulation and corruption. If the community is a civic one, her beliefs are justified and she herself prefers a low level of regulation and a high level of entrepreneurial activity without negative externalities. On the contrary, if an individual thinks she lives in an uncivic community, she expects high levels of regulation and corruption and a low level of entrepreneurial activity. Her beliefs are justified in the case of uncivic community thus leading to high regulation, corruption and low entrepreneurial activity.

The empirical analysis provides support for the model. Thus, those who distrust others are likely to: 1. believe that competition is harmful, 2. call for more responsibility of the government and 3. believe that the economy runs badly under democracy (PITLIK; KOUBA, 2014). The analysis also shows that, in the transition economies in Eastern Europe, the transition from socialism reduced dramatically government control and regulation but, as the model predicts, increased the creation of externalities and corruption because of the low level of civicness in these countries. In the next step, then, the demand for regulation increased due to externalities and corruption (PITLIK; KOUBA, 2014).

Figure 2. Trust and regulatory complexity



Fonte: Elaborated by the authors.

The Figure 2 illustrates the strong negative correlation between trust and regulatory complexity. Trust is measured in the way described in section 2. In measuring the complexity of regulation, we use the World Bank Doing Business data in 1997-2009. According to the guidelines given in a report from the World Bank (2012), we construct a variable measuring the complexity of regulation as an average of the country rankings of the following original variables: starting a business, dealing with construction permits, getting electricity, registering property, paying taxes and trading across borders. These original variables measure the number of procedures and/or cost (in time or money) of those activities related to starting business, dealing with construction permits and so on. The figure shows graphically exactly the same tendencies which are more profoundly analysed by Aghion et al. (2010). Thus, we see that in the Scandinavian welfare economies, high level of trust is associated with low level of regulatory complexity. In contrast, in many Latin-American and East-European countries, low level of trust is associated with high level of regulatory complexity.

Three questions (for further studies) emerge from the analysis. Two of them are noted by the researchers themselves. First, the demand for regulation is also predicted by legal origins, as summarized in La Porta, Lopez-de-Silanes and Shleifer (2008) and Djankov et al. (2008). The main question then is how trust is related to legal origins? Does a French legal origin tend to increase both regulation and control and decrease trust? Do English and Scandinavian legal origins do the same or vice versa? Note that reference to legal origins involves a several century time-span: did French and English legal cultures respond to roughly concurrent but different societal disorders in French and in England before the era of colonization, and does this explain the suggested difference in trust and regulation between countries colonialized either by France or England?

Second, Aghion et al. (2010) point to education. Their analysis rests on the idea that education relevant for civic capital occurs in families. They therefore ponder whether an educational programme aimed to reduce distrust could be implemented in schooling in countries where distrust is prevailing. They also note that it might be difficult to raise the level of trust (civicness) through schooling if parents responsible for the family-based education are not interested in raising trust/civicness.

A further question, not suggested by Aghion et al. (2010), is the role of religion. As found by Guiso, Sapienza and Zingales (2003, p. 226-228), religion is a significant factor in trusting others as well as in a legal system. Furthermore, Protestants trust more than Catholics, and Protestants are less willing to cheat on taxes and accept a bribe. As in the case of legal origins, religion also involves a long time-span. A natural starting point is the (Protestant) Reformation several hundred years ago in which various elements of Protestantism fostered the development of social trust and other values and beliefs (such as our notion of the scope of morality) related to the horizontal relations between fellow citizens.

5 Conclusions and future challenges

The above story goes as follows. Civic capital appears to be a factor able to explain partly why there are country-level differences in economic performance and why such differences may exist over long time periods. We have focused on some ingredients of civic capital – namely trust (and distrust), scope of morality and fairness. In the Scandinavian welfare economies, trust is high, the scope of morality is wide, and an egalitarian fairness rule based on the perception of the relatively important role of 'luck' in generating individual success is prevailing. In addition, regulatory complexity is at a low level due to civicness.

These ingredients of civic capital form a part of the social infrastructure within which individuals and firms frame their decision situations: what are the alternative courses of action, who are the co-players, what are the likely consequences of each action, and what probabilities are attached to each consequence? If civic capital is 'high' a person assumes that many people outside the circle of family and community comply with promises and expectations based on shared social norms, regulatory rules or laws; therefore, the person realizes that it is profitable for her also to comply. In consequence, less complex regulatory systems work well. Alternatively, if the civicness is 'low', a person assumes that only few people outside the circle of family and community comply with promises and expectations based on shared social norms; therefore, it is unprofitable for her to comply either and, consequently, more a complex regulatory system is required.

A further question is related to the challenges of the Scandinavian Welfare Model. Can the current prolonged economic slowdown together with a tendency to cut tax rate and welfare spending harm the equilibria described above? In addition, will civic virtues continue to be at a high level in the Scandinavian welfare economies? The following challenges can be stated:

1. In general, as civic capital is a form of intangible capital, it must be vulnerable to depreciation. Guiso, Sapienta and Zingales (2003) mention some examples. First, civic capital may become weakened if the social fragmentation in a community increases due to immigration or an increase in income inequality. Second, large scale historical or financial events and episodes such as dictatorship and civil wars or episodes in financial crises can also depreciate civic capital (SAPIENZA; ZINGALES, 2012).
2. Regarding the analysis of the European-style equilibrium by Alesina and Angeletos (2005) (which may, perhaps, be more apt to the Scandinavian welfare economies than to other European countries), the undermining of the fairness rule based on the perception of 'luck' as the main determinant in the success of life would cause a decrease in the support of redistribution. There are two possible courses: one, where hard work is seen as a way of getting success in life; the other, where people perceive (either correctly or incorrectly) that not hard work nor luck, but connections (based on family

ties and other social bonds) determine one's success in life. In both cases, the prevailing fairness rule could be undermined and the support of redistribution could be decreased.

3. Finally, the balance between the amount and complexity of regulation on the one hand, and the level of civic capital on the other hand, can become subverted by the factors mentioned in item 1 and by the failures of government to develop regulation coherently and by preserving sensitivity to the demands of citizens and firms.

All in all, concerning the Scandinavian welfare economies and by excluding unexpected shocks, the main challenges are related to immigration, increase of income equality, financial crisis aftermath, failures in regulation and changes in the importance of 'hard work', 'luck' and 'connections' as the main determinant of success in life. These are, indeed, much debated issues in Denmark, Finland, Norway and Sweden. It is noteworthy, however, that both cultural and political institutions in these countries are stable and 'experienced' to respond to the above challenges, although there are differences, too. For example, Sweden and Denmark have a long experience in populating immigrants, whereas Finland is quite inexperienced in this matter.

O MODELO DE BEM-ESTAR ESCANDINAVO E O PAPEL DO CAPITAL CIVIL: EXPERIÊNCIA PASSADA E DESAFIOS FUTUROS

Resumo: Este artigo introduz o conceito de capital civil explicando o porquê do modelo de bem-estar escandinavo ter sido tão bem-sucedido em gerar um desempenho econômico durante as décadas recentes. Capital civil se divide em vários fatores mensuráveis, dos quais a confiança, o escopo da moralidade e a justiça são tratadas com mais detalhes no presente artigo. Pesquisas recentes mostram que os fatores citados possuem influência na produtividade, na saída per capita e no nível e complexidade da regulação, e, ainda, são associados ao bom desempenho econômico do modelo escandinavo de bem-estar.

Palavras-chave: capital civil; Escandinávia; desempenho econômico.

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