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The Puzzle of the Scandinavian Welfare State and Social Trust

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Abstract

The Scandinavian welfare model is a puzzle to economists: It works economically, even though free-riding should prevail with its explosive cocktail of high taxation and high social benefits. One possible solution to the puzzle could be the unique stock of social trust present in Scandinavia. Here, the four Scandinavian countries (Norway, Denmark, Sweden, and Finland) form the top three with scores above 60 percent social trust on a ranking that covers 94 countries from all over the world.

Keywords: Scandinavian welfare state, social trust, free-riding, cooperation, wealth

1. Introduction

Economists have long wondered why people in given situations appear to cooperate more than they are expected to (Brandt & Svendsen, 2010). A typical example of a cooperation situation can be illustrated as a prisoner's dilemma, where two prisoners can choose to cooperate or not. The largest payoff is received if both prisoners cooperate, but if one 'cheats' and fails to cooperate, his payoff will be even greater, whereas the other prisoner's payoff will be significantly smaller. Each prisoner thus has an incentive to cheat and deviate from the optimal solution, namely to cooperate (Poulsen & Svendsen, 2005).

Try to explain classically trained American economists how the Scandinavian welfare model works and they will most likely shake their heads, smile, and say: "You must be kidding!" But we are not kidding. We can see that the welfare state does in fact work, despite strong incentives to moonlight, not pay taxes, and try to receive as many welfare benefits as possible. The 'bumblebee' keeps flying – and it is still in great 'socio-economic' shape (Svendsen & Svendsen, 2016). How is this possible? What is the answer to the Scandinavian puzzle?

Regarding traditional factors of production, most experts agree that human capital (education and vocational training) explains approximately half of a country's economic level, whereas physical capital explains approximately one fourth. However, the economists cannot explain the remaining fourth of a nation's wealth, which means that they must have overlooked something (Svendsen, 2014). This flaw in economic theory may be due to a missing link: social capital, here measured in the form of social trust.

This approach is justified by everyday observations and experiments that show that people continue to cooperate – even if the optimal choice for the individual person is *not* to cooperate, i.e. free-ride at the expense of others, who thus have to work even harder (Brandt & Svendsen, 2010). Think of George Orwell's *Animal Farm*, a parody of the communist society. Here the new 'idealistic' leaders on a farm taken over by animals (the pigs) free-ride at the expense of the workers (the other animals). The naïve and conscientious horse Boxer constantly tries to solve the problem 'by working harder', until he works himself to death.

When the free-rider problem is overcome in most cases, it may be because a third party enforces formal rules which create the optimal (cooperative) equilibrium; at least this has traditionally been the economists' recommended solution to coordination problems. But in many situations this does not explain cooperative behavior. In some cases formal rules do not exist or are not enforced, and in others cooperative equilibrium may be illegal according to the given society's rules (Svendsen & Svendsen, 2006).

Another possible explanation for the phenomenon of absent free-riding and surplus cooperation could be that something is missing from specifications of the profit functions that indicate the players' payoff for each result. We fail to factor in that the active players 'know each other', or, in economic terms, that each player has expectations to the other players, i.e. the likelihood that the other agent chooses to cooperate. So, in addition to society's official and formal rules, we have a set of social norms that affect the economic agents' preferences and, thus, their optimal choices. This is also true if we focus exclusively on a 'one shot' game

and not on repeated games, where the players can discipline each other's behavior (Poulsen & Svendsen, 2005). Thus, this 'something' we are looking for may be explained by the presence of the umbrella concept 'social capital', which has built bridges between the social sciences and strengthened cross-disciplinary cooperation in a large number of areas (Ostrom & Ahn, 2009).

For example, a used car salesman who double-crosses a customer grossly will be cursed up and down by the customer and it will affect his reputation, resulting in fewer customers for his cars, as the customers will lose faith in the salesman. However, trust is necessary for the used car salesman, as it is difficult for ordinary people to determine whether a car is a wreck or not. Trust, as in the customers' expectation of not being double-crossed, precisely compensates for asymmetrical information; the used car salesman knows a lot more about cars than most of his customers. In cases where this social mechanism of discipline works, the problem of free-riding will diminish. The extra costs involved in double-crossing will make it more attractive for the salesman to cooperate and get satisfied and happy customers, who will return and recommend his shop to other possible car buyers. In a car repair shop customers can sometimes borrow a car while their own car is being fixed. There are countless examples like these of the ways in which Scandinavians (who do not know each other) trust each other – not 'blindly', but because it is highly likely that they *can* in fact trust each other and thus save themselves a lot of time-consuming hassle and costs. Scandinavians do not need to constantly protect themselves against cheating (Svendsen & Svendsen, 2006).

In the same way the Danish welfare state arguably builds on trust and the absence of large-scale cheating in the system. Existing (high) taxes and the extent of welfare services are based on confidence that others work and pay their taxes too – rather than moonlight or sleep on the couch all day (Jensen & Svendsen, 2011). If not, individual taxpayers would soon protest and stop paying their taxes; in such cases the public finances would suffer, as has been the case in countries like Greece.

When trust prevails, more transactions can take place at lower costs, and predictability and production in society will increase, because formal measurement and enforcement of all transactions is no longer necessary. This implies that if the members of a society generally trust each other, they may obtain higher collective economic growth than in similar societies without mutual trust (Serritzlew et al., 2013; Bjørnskov, 2009). Similarly, trust in institutions means that political decision-makers can implement regulations more easily, because the citizens have no fear of being double-crossed. They know that their tax money is being invested properly, and that they will gain a satisfactory profit in the form of common goods – they get their money's worth. Furthermore, the need to control the behavior of the citizens is greater in low-trust societies than in high-trust societies.

Based on the work of the American sociologist Coleman (1988, p. 95), social capital can simply be defined as the ability to cooperate without written rules and extensive contracts. If the appropriate norms for cooperation exist, people can come together to enable more transactions without third-party enforcement. In the following we will focus on *positive* social capital, where group formation promotes economic growth as a new factor of

production. In other words, we exclude cases where negative or dark social capital, for example mafias and other criminal organizations, obstructs the economic growth of a country (Graeff, 2009; Graeff & Svendsen, 2013).

2. Social Trust

Social capital and the ability to cooperate are hardly measurable. Therefore, the concept is first and foremost operationalized as social trust (Paldam & Svendsen, 2000). Offe (1999) defines trust as trust in persons that springs from earlier experiences with specific persons. In continuation of this definition we propose that social trust is defined as the expectation that a stranger will adhere to a given norm. In other words, trust harbors the expectation that another person or a bureaucrat in a formal institution will not breach the norm and cheat whenever a private net advantage could be gained by doing so. A norm (from the Latin *norma*, meaning a carpenter's rule) defines which action is right and which is wrong. Likewise, the welfare state prescribes that it is good to work and contribute to the common pool which finances welfare benefits.

Social trust differs fundamentally from trust, as it is expanded to include people of whom the trusting party has no direct information, such as other citizens and taxpayers in the welfare state. Social trust in non-specific people (strangers) is typically measured as the extent to which a person thinks he can trust most people. Trust in most (but not all) people under most (but not all) circumstances simply means that a person trusts most strangers.

Thus, social trust also tells us something about the probability of being double-crossed by people we do not know personally. Therefore, social trust may also convey something about the ability to cooperate. The smaller the risk of being double-crossed, the easier it is to cooperate with a stranger or an institution of which you do not have full information (Svendsen & Svendsen, 2016).

In Scandinavia there are firmly established social norms against cheating one another. Here people tend to keep their word. This type of basic trust in others 'lubricates' the system. We see it in our daily lives in many ways, discrete and unnoticed, as small things that make everyday life easier. Of course, this is not new. Already in 1766, the economist Adam Smith saw that the degree of trust in other people varies among countries. He concluded that the Dutch were best at keeping their word, and that the risk of being cheated here was very small (Smith, 1997).

Besides social welfare, such resource savings also create an economic competitive advantage in relation to countries with widespread cheating and where people constantly have to guard themselves against swindlers. John Stuart Mill (1848) argued that there are countries in Europe where it is difficult to do business due to cheating and lack of trust. It is no doubt more fun to live in a society where people keep their word than in a society where you are cheated or assaulted every time you turn your back on people. If a behavioral norm of behaving properly can be maintained, it is good for the overall economy; simply because it takes fewer resources to do business with each other.

For example, it is easier to sell a horse in a high-trust society; the parties shake hands on the deal, and the buyer can send the money a week later. In a low-trust society there is a big risk that the buyer takes the horse with him and forgets to send the money. To safeguard himself from this type of cheating, the seller needs to prepare a written contract, which the buyer has to sign. This takes time. If the buyer still fails to pay, the seller is forced to hire lawyers and sue the 'buyer' or simply get help from some thugs to get the horse back or bring home the money. Time is thus spent on expensive disputes of this kind – time that could have been spent on making society happier and richer (Svendsen & Svendsen, 2006).

As mentioned, social capital in the form of cooperativeness and social cohesion in a population is normally operationalized as social trust. We know how Scandinavian countries are placed in relation to other countries in terms of trust, because we have measures from both the World Values Survey and the Danish Social Capital Project (SoCap) (Svendsen & Svendsen 2010). Here social trust is measured as the percentage of the population that answers 'yes' when asked whether they feel that they can trust most other people in the population. This question is taken from the World Values Survey (Inglehart et al., 2004) and was originally developed by Morris Rosenberg (1956). Figure 1 shows the social trust scores for 94 countries ranked according to average over time, i.e. from the first wave (early 80's) to the last wave (2008-9).

Focusing on the average scores for each country, the four Scandinavian welfare states (Norway, Sweden, Denmark, and Finland) are clustered at the top with more social trust than the other countries. The average for Scandinavia as a whole is 63.4 percent, i.e. well above 60 percent. Danes are the most trusting people at the moment (76.0 percent in 2008-9). The Netherlands comes in fifth with an average 55.9 percent score; thus, Adam Smith's remark from 1766 that the Dutch keep their word is still true.

Following the lead group we find other Western countries like New Zealand (49.1 percent), Switzerland (47.7 percent), Canada (46.9 percent), and Australia (45.3 percent). The USA has a 41.6 percent average score over time and scored 39.6 percent last time (2005-7); the country has thus experienced a significant drop of approximately 10 percentage points since the early 1990s.

Germany holds a 36.2 percent average score – the first three measurements cover West Germany alone, whereas the rest cover both West Germany and the former East Germany (Svendsen & Svendsen, 2010). Note that West Germany scores approximately 42 percent in the mid-1990s, whereas the former East Germany (number 39 on the list) scores 25 percent. This difference might be a result of the different institutional designs in the two areas – a natural experiment where two different political systems yield two different trust scores.

Table 1. General trust in 94 countries. Percentage of respondents who state that 'most people can be trusted' ('don't know answers' are excluded). Ranked according to the average score

		World Values Surveys						
		Early 80s	Early 90s	Mid-90s	2000	2005-7	2008-9	Average score
1.	Norway	61.2	65.1	65.3			75.1	***66.7***
2.	Sweden	57.1	66.1	59.7	66.3	68.0	70.7	***64.7***
3.	Denmark	56.0	57.7		66.5		76.0	***64.0***
4.	Finland	57.2	62.8	47.6	58.0	58.8	64.7	***58.2***
5.	Netherlands	46.2	55.8		59.8		61.7	***55.9***
6.	China					52.3		***52.3***
7.	New Zealand			49.1				***49.1***
8.	Switzerland		43.2	41.0		51.1	55.4	***47.7***
9.	Indonesia				51.6	42.5		***47.1***
10.	Canada	49.6	52.4		38.8			***46.9***
11.	Vietnam				41.4	52.1		***46.8***
12.	Australia	47.8		39.9		48.2		***45.3***
13.	Iceland	39.8	41.6	43.6	41.1		51.4	***43.5***
14.	Japan	40.8	41.7	46.0	43.1	39.1		***42.1***
15.	USA	46.8	50.0	35.6	35.8	39.6		***41.6***
16.	Thailand					41.5		***41.5***
17.	Ireland	41.1	47.4		35.2		38.9	***40.7***
18.	Northern	47.4	44.8		39.5		30.8	***40.6***
19.	Great Britain	44.4	43.6	29.7	29.7		40.3	***37.5***
20.	Germany	29.8	37.9	41.8	34.8	34.1	38.8	***36.2***
21.	India		34.6	39.2	41.0	23.3		***34.5***
22.	Austria		31.8		33.9		36.8	***34.2***
23.	Belarus		25.5	24.1	41.8		44.8	***34.1***
24.	Azerbaijan			20.5			44.9	***32.7***
25.	Belgium	30.2	33.2		30.7		34.6	***32.2***
26.	South Korea	38.0	34.2	30.3	27.3	30.2		***32.0***
27.	Spain	34.5	33.8	29.8	36.2	19.9	34.3	***31.4***
28.	Taiwan			38.2		24.2		***31.2***
29.	Italy	26.3	35.3		32.6	29.2	30.8	***30.8***
30.	Montenegro			32.3	33.7		24.9	***30.3***
31.	Russia	35.2	37.5	23.9	23.7		29.9	***30.0***
32.	Jordan				27.7	31.3		***29.5***
33.	Ukraine			31.0	27.2	28.3	28.9	***28.9***
34.	Luxembourg				26.0		31.1	***28.6***
35.	Czech Republic		30.2	28.5	23.9		30.1	***28.2***
36.	Egypt				37.9	18.4		***28.2***

	World Values Surveys						
	Early 80s	Early 90s	Mid-90s	2000	2005-7	2008-9	Average score
37. Lithuania		30.8	21.9	24.9		29.9	***26.9***
38. Dominican		26.5					***26.5***
39. East Germany		25.6	24.9		28.3		***26.3***
40. Estonia		27.5	21.5	22.8		32.6	***26.1***
41. Pakistan			20.6	30.8			***25.7***
42. Albania			27.0	24.4			***25.7***
43. Bulgaria		30.4	28.6	26.9	22.0	17.9	***25.2***
44. Hungary	33.2	24.6	22.7	21.8		21.2	***24.7***
45. Ethiopia					24.4		***24.4***
46. France	24.8	22.8		22.2		27.2	***24.3***
47. Poland		34.4	17.9	18.9	19.5	27.6	***23.7***
48. Bosnia-Herzego			28.3	15.8		26.6	***23.6***
49. Israel				23.5			***23.5***
50. Mexico	17.6	33.5	28.1	21.3	15.6		***23.2***
51. Nigeria		23.0	19.5	25.6			***22.7***
52. Armenia			24.7			20.5	***22.6***
53. Greece				23.7		21.3	***22.5***
54. Bangladesh			20.9	23.5			***22.2***
55. Uruguay			22.1				***22.1***
56. Latvia		19.1	24.8	17.1		25.5	***21.6***
57. South Africa	30.6	28.4	18.2	11.8	17.5		***21.3***
58. Malta				20.7		21.7	***21.2***
59. Andorra					20.7		***20.7***
60. Croatia			23.6	18.4		19.7	***20.6***
61. Georgia			18.7			22.1	***20.4***
62. Argentina	27.0	23.3	17.5	15.4	16.9		***20.0***
63. Chile		22.7	21.9	22.8	12.4		***20.0***
64. Slovak		23.0	27.0	15.7		12.6	***19.6***
65. Slovenia		17.4	15.5	21.7	18.1	24.2	***19.4***
66. Serbia			29.8	18.8	15.3	11.8	***18.9***
67. Morocco				23.5	13.0		***18.3***
68. Mali					17.5		***17.5***
69. Singapore				16.9			***16.9***
70. Moldova			22.2	14.7	17.9	12.5	***16.8***
71. Romania		16.1	18.7	10.1	20.3	17.6	***16.6***
72. Portugal		21.4		10.0		17.2	***16.2***
73. Ghana			22.4		8.5		***15.5***
74. Venezuela			13.7	15.9			***14.8***

	World Values Surveys						
	Early 80s	Early 90s	Mid-90s	2000	2005-7	2008-9	Average score
75. Burkina Faso					14.7		***14.7***
76. El Salvador			14.6				***14.6***
77. Puerto Rico			6.0	22.6			***14.3***
78. Macedonia			8.2	13.5		20.1	***13.9***
79. Zimbabwe				11.9			***11.9***
80. Zambia					11.5		***11.5***
81. Algeria				11.2			***11.2***
82. Kosovo						11.2	***11.2***
83. Cyprus					12.8	9.2	***11.0***
84. Colombia			10.8				***10.8***
85. Albania						10.6	***10.6***
86. Turkey		10.0	5.5	15.7	4.8	11.0	***9.4***
87. Malaysia					8.8		***8.8***
88. Tanzania				8.1			***8.1***
89. Uganda				7.6			***7.6***
90. Peru			5.0	10.7	6.4		***7.4***
91. Philippines			5.5	8.4			***7.0***
92. Brazil		6.7	2.8		9.2		***6.2***
93. Rwanda					4.9		***4.9***
94. Trinidad/Tobag					3.8		***3.8***

Together with Germany it is remarkable how other European countries such as Great Britain (37.5 percent), Austria (34.2 percent), Spain (31.4 percent), Italy (30.8 percent), France (24.3 percent), Romania (16.6 percent), Portugal (16.6 percent), Cyprus (11.0 percent), and Turkey (9.4 percent) have relatively low scores compared to the Scandinavian countries. Other examples include India, which holds a 34.5 percent score, and Russia with 30.0 percent.

The three countries ranked at the bottom are Brazil (6.2 percent), Rwanda (4.9 percent), and finally Trinidad/Tobago (3.8 percent).

Overall, the four Scandinavian countries hold unique stocks of social trust. The above 60 percent average over time of the top four Scandinavian countries is remarkable compared to the rest of the world. This huge variation across countries highlights that Scandinavia has 'something' special. Consequently, the observed scores for social trust thus offer the first explanation of how the Scandinavian bumblebees stay in the air.

3. Conclusion

We have argued that the missing 'something' for explaining the puzzle of the well-functioning Scandinavian welfare state could be the countries' unique level of social

trust. The overall result is clear: Scandinavians are the world's most trusting people. The top three (Denmark, Norway, and Sweden) held more than 70 percent social trust in 2008-9, which means that near three out of four citizens trust most other people in these countries. Social trust may therefore be the 'Scandinavian gold' that makes the bumblebee fly. It is easier for people who trust each other to work together, as the risk of being cheated is smaller. Therefore, social trust is a useful measure to describe the ability to cooperate across countries. It would be relevant to introduce more cases from both private and public companies in future research based on different types of control and trust monitoring. Increased use of delegation and trust-based management in everyday life will probably be visible at the bottom line (because trust requires less resources than control) in the form of increased employee satisfaction, more volunteerism and less absenteeism due to illness (which will also be visible at the bottom line).

In perspective, the comparative advantage of social trust for the Scandinavian welfare state has to be highlighted even further in future research. So, in order to preserve and expand the existing stock of social trust it is crucial to explore and understand how it is accumulated. This insight into the 'Scandinavian gold' may be nurtured and exported, for example as trust-based management principles to the USA. It may, however, also disappear again if not properly maintained. If the Scandinavian high-trust societies should in the future turn into control societies, they will probably no longer be among the world's leading countries in terms of socio-economic success.

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