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Rögnvaldur Hannesson, *Debt, Democracy and the Welfare State: Are Modern Democracies Living on Borrewed Time and Money*, Palgrave Pivot, 2015, 115 pp. $64 Hardcover.

By Editorial

Abstract. This book deals with the accumulation of government debt in twenty-two of the richest countries of the world, which has been ongoing since about the mid-1970s. All these countries are welfare states with a large government sector that provides services and transfers purchasing power to the perceived needy, although some countries are more ambitious in this respect than others. The build-up of debt is due to maintaining welfare expenditures beyond what tax revenues allow. But indefinite debt accumulation is not an option. The question is whether the governing elites in democratic countries will shrink from doing what is necessary in fear of losing their electorate, in the end opening the way to unenlightened populists and potential usurpers.
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Book Review

Chapter One traces the development of government debt for these countries since the Second World War or shortly thereafter. The countries involved are the long-standing members of the OECD, which comprise most of the richest countries of the world and those that have the oldest and most developed welfare states. Countries that were actively engaged in the war built down their debt gradually during the first decades after the war. From the mid-1970s most countries began to accumulate debt; in some countries this process began earlier and in some a bit later.

In many countries this process has continued relentlessly, with the debt level reaching world war proportions, while some countries have managed to reverse the accumulation of debt. It is noteworthy that the latter countries are relatively small. Perhaps lenders lose confidence in small countries' ability to pay earlier than they do for large countries. The difference between government borrowing and individual borrowing (or borrowing by firms) is less than Keynesian thinking would have us believe; lenders are unwilling to lend to countries they do not believe will be able to pay them back or which will inflate their way out of their obligations.

Chapter Two discusses why government debt has risen. Prior to the energy crisis in 1973 economic growth was rapid in almost all countries, which enabled them to increase public expenditure and consumption rapidly. The recession that followed in the wake of the energy crisis was generally seen as temporary, and most governments tried, in a traditional Keynesian way, to bridge the gap caused by the recession. But it turned out to be of longer duration than expected, and economic growth did not quite revert to the previous golden age in most countries. Thus began the accumulation of government debt, of which we have not yet seen the end in many countries.

Trivially, rising government debt is due to expenditures outpacing revenues, but is it due to a too high level of ambition for welfare transfers and public consumption, or is it due to inability to raise tax revenue? There is little or no correlation between GDP per capita, public consumption (as percent of GDP), or public expenditure (also in percent of GDP) and government debt (as percent of GDP), which suggests that a large debt is due to inability to raise taxes to pay for whatever expenditure a country has rather than a high level of public expenditure or consumption.

As discussed in Chapter Three, the public sector has expanded because of the rise of the welfare state. There is, however, no law of nature that says that governments must provide an ever increasing amount of services or transfers; the fact that this has happened must be sought in the political sphere. Among the political factors behind the rise of the welfare state is the rise of the labor movement and the extension of the right to vote. The labor movement and associated political parties saw universal health and educational benefits as well as various social transfers as in their interest. Furthermore, the scarcity of labor caused by the Second World War and post-war economic growth strengthened the political power of labor. Finally, the rapid post-war economic growth made it easy to expand public services and transfers because private consumption could expand simultaneously.

But there are also structural reasons behind the expansion of the public sector. These are known as “the cost disease model,” which is based on the premise that technological progress is more rapid in manufacturing than in the provision of public services such as education and health services. If both manufacturing and public services are to expand at the same rate, more and more of people’s incomes must be diverted to taxes to pay for public services. There are limits to how far this development can proceed, obvious in principle but less easily pinned down in practice. There is no other solution to this other than increased privatization of such services, which is indeed happening. The expansion of the public sector has largely come to a halt in most rich countries, but a gap between welfare ambitions and reluctance to pay for them is indeed likely to be one cause behind the build-up of government debt. It is noted that some of the economic growth in the decades after the Second World War was due to the transfer of services from the informal household economy to the formal part of the economy where people (mostly women) are paid for taking care of children and the aged in specialized institutions instead of at home.

No society entirely abandons the weak; indeed we are genetically programmed to care of our young, who otherwise would perish. But whom we take care of and how well depends on what we can afford; poor, primitive societies have abandoned their old and infirm. Our immense wealth has made the welfare state possible, and in the heyday of economic growth it grew rapidly. But has it, perhaps, been taken too far? The ability to pay for public services and government transfers depends on the productivity of the private economy; how much people are willing to work and invest in better technology. Taxes, whatever they are used for, weaken the private incentives to work and to invest. Have we gone too far? Chapter Four discusses the welfare state, its development and rationale. Even if Bismarck is credited with initiating the beginnings of the first welfare state its growth is undoubtedly due to the rise of democratic government responsive to demands from citizens and spreading the wealth of industrial nations more widely. Satisfying those demands without raising revenues commensurately leads to government deficits, which indeed is what has happened.

Will democratic governments be able to deal with the debt trap? How good is democracy anyway, compared to enlightened authoritarianism? This is discussed in Chapter Five. The modern form of democracy bears only a superficial resemblance to the democracy practiced in the ancient Greek city states. The modern state is a much too complicated entity to be ruled by general assemblies or referenda. It can only be governed by specialized elites and a cadre of civil servants. The fact that the governing elite is selected by common vote is what confers the name of democracy on this system, but that selection process leaves much to be desired.

Modern democracy works well when there are competing and competent elites that respect each other and the rule of law, when there are informative mass media free of the elites, and when there is an independent judiciary. But will the established elites be able to deal with the challenges rising out of debt accumulation and economic stagnation? There is reason to fear they will be thrown out of office, not necessarily for being incompetent but for not having delivered what the electorate expected and was perhaps promised. Will they be replaced by unenlightened populists or usurpers? That is what happened eighty years ago in Germany as a result of economic chaos and frustrated expectations. Human nature and judgment has not undergone a revolutionary change for the better in the meantime.

Is democracy essential for economic progress and general welfare? The rise of the modern industrial world began with the industrial revolution. Some have traced the roots of the modern industrial state to the Glorious Revolution when William of Orange agreed to share his power with the English parliament. But at that time, and for a long while afterwards, only a small minority (of the order of 5 percent of the relevant age groups) had the right to vote. But it was a decisive minority, one that identified its interests with trade and industry and so, by promoting its own interests, also promoted industrial development and trade. Successive extensions of the right to vote have undoubtedly spread wealth wider, but does it perhaps contain the seeds of its own destruction? In many rich countries the majority of the electorate gets its income from the state, either as public employees or recipients of transfers such as pensions and disability payments. Will this majority see its interests best served by taxing the market sector of the economy for its own benefit and undermine the source of its own wherewithal? Without a vibrant market-oriented sector the welfare state will wither.

There is less difference between an enlightened authoritarianism and modern democracy than many people are willing to admit. No modern country can be governed without a specialized governing elite. The economic "miracles" we have seen in recent decades, primarily in East Asia, all began under enlightened authoritarian governments, some of which are still that way. While unenlightened authoritarian states are numerous and well known, failed democracies also are unfortunate facts of history. The score card of democracy is less clear than many people would like to believe. While democracy superficially would seem to promote the interests of the general public, in fact it is prone to promote special interests that are concentrated enough for people to use their time and resources to lobby governments.

The debt problems of some European Union countries using the euro as currency have been particularly acute and caught much attention. The euro arrangement is discussed briefly in Chapter Six. Going back to the pre-euro inflationary circus will not be easy. The countries of southern Europe which adopted the euro did so precisely to break out of that inflationary spiral and avoid repetitive devaluations which were hard to reconcile with free capital movements across inter-EU boundaries.

Some rich democratic countries have succeeded in reversing the build-up of government debt, although some of them have seen it rise again after the financial crisis of 2008. This gives us some hope that democratic countries will in fact be able to deal with the debt legacy. But it is unlikely to happen until a sense of an urgent crisis has gripped both policy makers and their electorate. This is in any case the lesson from Sweden, discussed in Chapter Seven. Sweden was one of the pioneers in building the welfare state, but by the 1970s it suffered from an increasing mismatch between rising welfare ambitions and retarded economic growth. This, and the sense that the post-1973 oil crisis recession was temporary, led to a rapid build-up of debt to an unsustainable level. It is noteworthy that parties across a wide political spectrum shared the outlook that Sweden could overcome its beginning difficulties by deficit financing, but when the resulting public debt approached an unsustainable level there emerged a similarly wide consensus about what needed to be done; curtailment in welfare expenditures and a reform of the pension system. A legacy of this consensus is that Sweden is now among the EU countries with the lowest debt to GDP ratio and one that did not increase after the financial crisis of 2008.