

Rents in a Welfare State

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Abstract

Denmark is the most developed welfare state. The private sector is sharply delimited and is kept efficient by secure property rights and free trade. Within the public sector, considerable rents in the form of excess costs of production seem to exist but are difficult to measure. However, a number of cases exist in which the rents have been revealed. The (implicit) welfare coalition is defined as the share of voters receiving their income from the public budget. In Denmark, this is the majority, and thus the median voter is within the welfare coalition. Rents are protected by this coalition. The large welfare expenditure programs have co-opted the NGOs in their field.

1. Introduction

The *welfare coalition* is defined as the group of those who receive their income from the public sector, either as a salary or as a social subsidy. This cross-partisan group is not a formal coalition but has common interests. This chapter discusses circumstances in which the median voter is within the welfare coalition. This is the situation in some of the North West European welfare states, and notably so in Denmark, where the welfare coalition is about 55% of voters.¹

1.1 *The language confusion of the welfare state and its huge success*

In the usual language of economics, welfare is a function of the consumption and leisure of the individual. There are *pure public goods* that occur in a few cases such as national defense, there are broader classes of impure or congestible public goods, and there are positive and negative externalities with public-good properties such as environmental quality. Economic theory has also studied these cases and has considered social welfare behind a veil of ignorance and the welfare and efficiency consequences of redistribution.²

The language of the welfare states uses the same words, but the words are given a somewhat different meaning. *Welfare* is taken to mean public spending. *Public goods* are the goods supplied by the public sector whether the goods have public-good properties or not. All *redistribution* is welfare enhancing. The terminology defines politicians as *benevolent* and policies as implemented by *unselfish and loyal* civil servants. The theory of rent seeking proposes that this is not the whole story.

The welfare state has been a huge success in Denmark: It has obtained the support of the great majority of the population and of the political parties. No war-of-attrition is fought around the welfare budget as in the USA and elsewhere. The public debt share (of GDP) is below half of that in the US and the Euro area.³ Also, it appears that the standard measures of trust, honesty and happiness are unusually high in the welfare states – notably so in Denmark.

The Nordic welfare states are rather efficient and have been consistently in the top decile of the countries in the world as regards wealth (see section 5.1 and 5.2). However, it is straightforward to give examples of rent seeking and rent extraction in the welfare state.

¹ The concept of *the welfare coalition* was developed by Henrik Christoffersen and the author; see Christoffersen and Paldam (2003) and Christoffersen *et al.* (2013, pp 261-63). Related concepts have been used by other authors.

² For an overview, see Hillman (2009).

³ Both the USA and the Euro area has debt shares around 100% of GDP.

1.2 Domestic and international aspects: immigration as rent seeking

This chapter focuses on rents and the public sector in the welfare state. There are international aspects as well, both relative to the third world and the EU. The Danish-type welfare state is ‘universal’ and the payments given are on a need basis with a small insurance element only. For immigrants, the Danish language is a considerable barrier to productive employment. Though English is widespread in Denmark, full labor market integration requires a considerable investment in the Danish language. Immigrants with a high labor market value will therefore choose to go to a country where the language barrier is smaller. A universal welfare state attracts the needy and less productive – obviously many potential immigrants would like to come and enjoy the rents of the welfare state. There is therefore adverse selection of immigrants. The adverse selection has made the rules of entry into Denmark increasingly stringent for immigrants from the Third World. With the enlargement of the EU in 2004, the problem of immigration into the welfare state has increased. With new EU members in low-income East and Southeastern Europe and the EU rules about free mobility, questions of policies regarding ‘welfare tourism’ arise. Immigration can pose significant problems for the universal welfare state. The problems of immigration subject to adverse selection have been studied and form central issues with regard to rents and rent seeking. The issues are known.⁴ There has been less information about domestic rents in the welfare state.

1.3 Rents and efficiency

Rents can be defined as privileged unearned benefits. Rents include monopoly profits but in the public sector rents are excesses above required costs. This chapter looks only at the public sector and some extensions of that sector, so rents include extra costs absorbed by bureaucracies. In the national accounts, public production is mainly calculated from the cost side, so rents are included in the GDP. Thus, in the short run, more rents mean that the GDP increases. However, GDP will have been decreased when the rents were contested using time and resources that could have been productively used. It is difficult to identify the rents in the public sector but from time to time events occur that reveal the prior level of rents or show how new rents are created.

A case of old rents revealed occurred when the EU liberalized air traffic. This forced the SAS, Scandinavian Airline (and many other ‘pampered’ airlines), to cut about half of the

⁴ Immigration to the welfare state has been discussed in a large literature. A good introduction is provided by the papers of the symposium in Paldam (2007), notably Nannestad (2007), and chapters 8 and 9 in Christoffersen (2014). See also Nannestad (2004).

budget to survive. In the 2-3 decades prior to the liberalization, SAS had managed to absorb rents in the order of 50% of the budget. This example is further discussed in section 5.3.

A fine case of new rent generated happened when a new law turned power at the public universities from bottom up to top down ten years ago. This caused the size and relative salaries of the bureaucracy at the top to start growing rapidly. At the university at which the author works, bureaucracy has increased its share of the budget by about 8% percent of the budget since the reform. At the same time, efficiency has fallen (see Paldam, 2014).

The chapter will proceed as follows: Section 2 reports the numbers for the size of the welfare coalition. Section 3 discusses the theory of this coalition. Section 4 describes the capture of a protective NGO rim of the coalition. Section 5 looks at the rents first from a macro perspective and then through examples. Section 6 concludes.

The text uses *mill* for million (10^6) and *bill* for billion (10^9). *Kr* is Danish Crowns that is fixed to the Euro at 7.45 Kr for one Euro. Names of Danish Institutions are translated, and where the Danish name is deemed necessary it is given in []-brackets.

2. Some numbers for the welfare coalition in Denmark

The welfare coalition has two parts: (W1) the public employees, (W2) the welfare recipients who receive most of their income from the public sector.⁵ Section 2.1 is an assessment of the share of the welfare coalition of the voters. Section 2.2 makes an additional point, as it turns out that the group (W1) is overrepresented in the Parliament.

2.1 The voters

The size of the welfare coalition among the voters can be inferred from tables 1 and 2, both based on the official data from Statistics Denmark. Table 1 is the population reached from the Central Personal Registry, which is known for its precision. Table 2 is calculated from business polls, which are less precise.

The last row (4) in table 2 divides the numbers in row (3) with the whole of the population from row (4) in table 1. It appears that only 47.0% of the population works. Recently it was in the news (see DR 13/1-2013) that only 3 of the 98 municipalities have a majority of working people. The population of eligible voters is 4.09 mill persons. The labor force is $2.84/4.09 = 0.695$ of the (eligible) voters.

⁵ In a developed welfare state virtually everybody receives something from the state, but for many it is a rather small part of their income.

Table 1. The population of Denmark, 3rd quarter of 2012

	Age group	Whole population		Eligible to vote (age 18) a)	
		Number	Share	Number	Share
(1)	0-14	981,023	17.6 %	-	-
(2)	15-24	708,620	12.7 %	447,241	10.9 %
(3)	25-64	2,911,143	52.1 %	2,675,505	65.4 %
(4)	65-up	986,299	17.7 %	965,744	23.6 %
(4)	All	5,587,085	100.0 %	4,088,490	100.0 %

Note: At the 2011 election 87.7 % voted, though 0.8 % of the votes were declared invalid.

a. People below the age of 18 and non-citizens are excluded.

Table 2. The Danish labor force, 3rd quarter of 2012

	Age Group	Labor force			Outside the Total	Sum
		Working	Unemployed	Labor force		
(1)	15-24	392,000	63,000	455,000	244,000	699,000
(2)	25-64	2,236,000	152,000	2,388,000	521,000	2,911,000
(3)	All	2,628,000	214,000	2,842,000	765,000	3,607,000
(4)	Share ^{a)}	47.0 %	3.8 %	50.9 %	13.7 %	64.6 %

Note: The missing $100 - (50.9 + 13.7) = 35.4$ % of the population is younger or older.

a. Share of population (5,587,085) from table 1.

b. The unemployment rate is thus $3.8/0.509 = 7.5$ % of the labor force, or $3.8/0.69.5 = 5.4$ % of the voters.

The share of W1, the public labor force as share of the labor force is about 29%, so $W1 \approx 0.695 \cdot 29\% = 20\%$ of the voters.

It is more difficult to calculate W2, the share of the voters receiving their main income as ‘welfare’. The Danish welfare state is a ‘universal’ one where people receive subsidies directly from the state and not indirectly from compulsory insurance arrangements. Hence, the state pays the benefits to the 5.4% unemployed, and the 23.6% pensioners, all of whom receive a public base pension [folkepension]. Also, the great majority of the 13.7% in the ‘working ages’ outside the labor force receive some welfare payment – this, for example, applies to the students. This all adds up to $W2 \approx 42.5\%$ of the voters.

This number is too high for several reasons: Some between the age of 65 and 70 still work; there are still a few in the ‘working age’ (i.e., ‘housewives’), who do not receive a public subsidy; and many pensioners have a private pension in excess of their public pension. However, the 7.5% unemployed hides about 3 times as many, who are unemployed for a period during the year.

My assessment is that when all adjustments are made, the number for W2 is still about

35%, so that $W1 + W2 = 55\%$ is a fair assessment of the share of the welfare coalition in the population. Thus, it is clear that the median voter is within the welfare coalition. Note that the group of public employees, $W1$, is only 20% of the voters, while the group of welfare clients, $W2$, is about 35%, so $W2$ is substantially larger.

2.2 *The welfare coalition in the Parliament [Folketinget]*

It is not easy to divide the MPs (Members of the Parliament) in the same groups as used in section 2.1, as many of the MPs are full-time politicians, with a loose association to the labor market. However, the Parliament issues a small report after each election (Folketinget 2012) with some statistic about the MPs, and each MP has a home page.

The statistics given sets the number of (previous) public employees ($W1$) in the Parliament at 30.9%. The public sector allows employees, who step out of a job to be MP, to come back to their old job, so it is less risky to be a MP for a public employee than for a person working in the private sector. The number of previous welfare recipients ($W2$) is set at 8.0% only. On the face of it, the welfare coalition does not control Parliament. However, the home pages of the members tell a story with three major qualifications:

(Q1) About 26% of the MPs have been members for more than a decade.

(Q2) About 14% has never held a full-time job outside politics. The two groups overlap somewhat, but they still add to about 35% the MPs. How they should be counted is unclear. MPs receive a salary from public funds, so it is arguable that after some time full-time politicians become public employees irrespective of what they did before. Nevertheless, many Danish politicians stress their prior job, much as Abraham Lincoln, who ran his first campaign as the rail splitter he once was (though it seems briefly only), and not as the lawyer he had become.

(Q3) Many the members of the Parliament (previously) working in the private sector actually worked in NGOs that belong to the gray zone between the public and the private sector (see section 4). Often they even worked in the secretariats of the political parties.⁶

The three qualifications allow a range of alternative counts of the past jobs of the PMs. I have made a number of such counts, and it is easy to reach the result that public employees ($W1$) alone have a majority in the Parliament. Consequently, I view the data as showing the welfare coalition is rather strong in the Parliament.

From all counts, it is clear that the welfare coalition in the Parliament is dominated by

⁶ Danish political parties receive a subsidy aiming at 'freeing' the parties from sponsor interests. The parties still get sponsor money, but hopefully they are not so willing to make murky deals to get it.

(W1), while (W2) welfare recipients are strongly underrepresented. One reason is that nobody above the age of 70 was elected in 2011. Also, even if you enter politics as unemployed there are many jobs in political NGOs that need to be filled. These jobs are largely financed from public funds. So by the time you are elected, you have nearly always worked for a period.

3. The core model of political equilibrium

This section starts with a model in which the welfare coalition generates a political equilibrium for the size of the public sector. Then it is argued that the equilibrium is not a stable economic equilibrium, i.e., it is not a steady state. And finally some empirics are introduced.

3.1 A core model for a political equilibrium

The model builds on two assumptions: (A1) The welfare coalition agrees on its own self preservation. (A2) The size of the welfare state is the *only* dimension in politics.

With these assumptions the *median voter model* applies. It says that a welfare coalition above 50% will ensure that it stays above 50%. However, the *minimum winning coalition* will cause that once it has reached 50% of the voters – as it actually has – it will remain only marginally above this level. The two models are well known (see for example, Mueller 2003, chapters 11 to 13; Hillman 2009, chapter 6), and will not be reviewed here. This will be termed the *political equilibrium result*. If the size of the welfare state is an *independent* dimension in politics, and there is *no logrolling*, it still holds.⁷

3.2 The political equilibrium is fuzzy: The coalition needs a safety margin

In practice, each of the conditions giving the theoretical result only holds to some extent. That is, they are true $\pm \varepsilon_i$, where ε_i is a measure of the fuzziness of condition i . So the political equilibrium may only apply with some uncertainty, which is an aggregate, $A_i(\varepsilon_i)$ of the fuzziness of each condition.

The fuzziness comes from: (1) The coalition is not explicit, but only a result of common interests. Surely, the permanent secretary and the unemployed shop assistant may not feel a strong solidarity. (2) The size of the welfare state is not the only issue in politics, and nearly all political issues have budgetary consequences. So the size dimension is somewhat dependent on all other dimensions. (3) The size is important for the development of the private sector in many ways. (4) Logrolling is the soul of politics, but, if the welfare

⁷ This is the well known Arrow-condition of independence of irrelevant alternatives.

coalition is strong, it may set the agenda. All of these fuzziness elements aggregate to a general uncertainty $A(\varepsilon)$ in the relation. It is an equilibrium that does not always hold.

The coalition will hold more often if the welfare coalition is made larger, but there are costs to the members of increasing the coalition above its minimum. This gives a typical trade off. With enough assumptions the model can be solved to yield an optimal size of a ‘working’ welfare coalition: It is $50 + S\%$, where S is a safety margin, S . Above, the size of the welfare coalition in Denmark was assessed to be about 55% – so perhaps the safety margin is $S \approx 5\%$?

3.3 *The political equilibrium is no economic equilibrium*

Two reasons why the political equilibrium is not an economic equilibrium will be discussed.

The first follows from the observation that long run productivity increases in the public sector are smaller than in the private sector. Why this is the case is a long story, but it is confirmed in the Danish national accounts since the late 1930s (see Paldam and Zeuthen 1988) and chapter 10 in Christoffersen *et al.* 2013). It is partly an artifact because it is difficult to calculate productivity in much of the public sector. Hence, production is calculated from the cost side. However, it is confirmed from a number of attempts to measure output. Thus, in the last 85 years, the annual productivity increases have been about 2% lower in the public than in the private sector in Denmark.

Given that difference in productivity, Baumol’s law applies: The economy has no steady state (see Baumol 1967, 2004). Some ratio must change steadily.⁸ If the welfare coalition wants to preserve itself, the share of public employment should remain the same. Given a wage parity between the sectors, this will keep the tax pressure constant, but, as productivity keeps rising in the private sector, the real share of the welfare state will fall steadily. This is unlikely to be possible.

The overwhelming majority of the Danish political parties agree that the welfare state should be preserved. This should probably be taken to mean that the real share of the public sector should be preserved. It implies that tax pressure will rise steadily. This is even less possible.

The second reason why the political equilibrium is no economic equilibrium follows from the logic of bureaucracy. Both the main theory of bureaucracy from Niskanen (1968, 1994) and various empirical studies show that bureaucracies want to grow (see Mueller 2003, chapters 16 and 21; Hillman, chapter 2). The only non-partial equilibrium in the Niskanen-

⁸ See chapter 10 in Christoffersen *et al.* (2013), which builds on the detailed calculations in Paldam (2009). The outcomes described in the next few paragraphs are derived in these papers.

type model of bureaucracy occurs when the size of the bureaucracy is so large as to appropriate the full consumer's surplus generated by public expenditure. However, a partial equilibrium arises when a budget constraint is in place through the political process. The argument above suggests that the constraint is relaxed when the welfare coalition is stronger, which of course means that rents increase with the size of the coalition.

Several attempts have been made to stop the expansion before that extreme limit, but with a sufficiently strong welfare coalition such attempts fail. It is easy to give examples of reforms sold under the name of rationalizations that have somehow resulted in larger administrative costs.

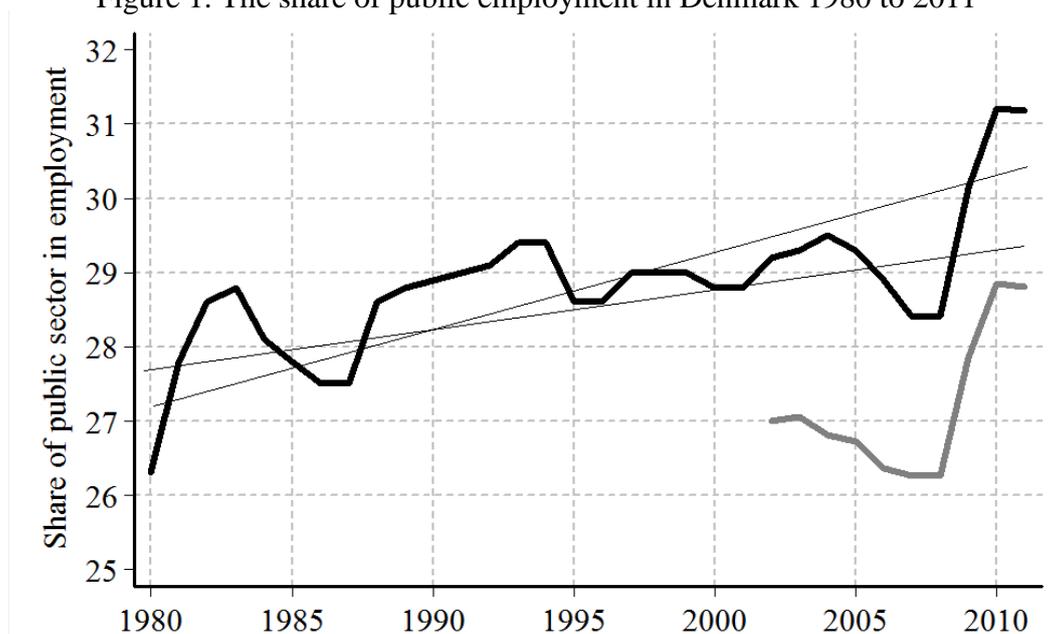
An example is the large municipal reform in 2004-07 when 271 municipalities were merged into 98. The reform was announced as a rationalization allowing benefit from economies of scale. However, strong political pressures occurred during the process of implementation that caused many of municipalities to promise voters that nobody was to experience a lower standard of welfare provision, because all merged municipalities were to go to the highest standard of any of the ones merged. Also bureaucrats were informed that there would be no job losses. At the end of the process it was proudly announced that the new municipalities had managed to find jobs for every bureaucrat. So the original purpose of cost savings through scale economies was turned into a triumph for the welfare coalition. The devil is certainly in the details in administrative reforms.

3.4 The zigzag path of WI

Figure 1 shows the path of the share of the Danish public employment as a percentage of total employment. In 1950 the share was at 7.5% and then from 1960 to 80 it grew dramatically at about 1 percentage point a year. The first observation in figure 1 shows the end of the big expansion. Since then the path has been more 'rocky'.

Figure 1 shows four rounds of public savings, when governments have tried to reverse the expansion, but as is shown, there has been an underlying upward slide in the share. Thus, saving rounds have been successful in the short run, but in the longer run the welfare coalition has prevailed. The large increase at the end is mainly due to the fall in the denominator during the crisis. The upward drift is estimated by the two thin lines, where the flattest disregards the first year and the last three years. The steepest line includes all years. It appears that the increase is in the range of 1½% to 3% over 30 years, so it is a slow drift of 0.05 to 0.1% per year.

Figure 1. The share of public employment in Denmark 1980 to 2011



Note: The main series from Statistics Denmark goes back to 1948. The gray line is an adjustment for part-time employment in the public sector. However, the adjustment is not made for the private sector and in the denominator.

3.5 The dynamic path: some suggestions

I have not discussed how the internal balance between the two parts of the welfare coalition is formed. However, it has been noted that the welfare recipients, W2, form the largest part of the coalition among the voters, while the public employees, W1, are much stronger in the parliament. The ones who actually implement the policies are in W1. Consequently, W1 is the most influential in practical decision-making.

It is also interesting that, when it comes to the budget, the share of public consumption is larger than the share of transfers – though the difference is not large.

The analysis in section 3.4 showed that W1 is sliding upwards, so that, if the coalition has to stay at the ‘working’ minimum (around 55%), the share of transfer payments is likely to fall correspondingly to the upward slide in public employment. This is not going to be easy due to demographic developments.

Given the Baumol-mechanism, the increase in the share of public employment will slowly increase the tax burden, but the increase will not be enough to prevent a fall in the real share of the public sector in GDP. Thus, the voters will experience: (1) falling transfer payments; (2) a falling share of the real public consumption; and (3) an increasing tax burden. All of these trends will be slow, but they will not be easy for the population to accept, and they will place strains on the welfare coalition.

4. Including the NGOs by an allocation of rent

In comparative studies of social capital, the NW-European countries – notably the Scandinavian countries – stand out as having unusually high social capital (see Bjørnskov and Svendsen 2007). One of the key dimensions is that the number of voluntary organizations, NGOs, is relatively large. NGOs are supposed to run on voluntary work and members contributions.

The welfare state extracts a little more than 50% of the incomes of people in taxes. This gives a large *tax wedge* between the primary income of a NGO member and an NGO employee of about $1/0.5^2 = 4$ for the lowest and $1/0.35^2 = 8.3$ for the highest marginal tax payers. If the VAT of 0.25 is included, it becomes even higher.

This makes it difficult for many NGOs to obtain voluntary contributions that allow them to employ some staff.⁹ Though many NGOs still run on voluntary work, a system of state subsidies has gradually crept in. This has turned many NGOs into semi-public organizations.

The largest NGO-activity is sport, as about 1.8 mill (millions) Danes are members of a large number of sports clubs, and here much voluntary work is done. The clubs have an ‘umbrella’ organization, DIF [Danmarks Idræts Forbund], which spent 997 mill Kr in 2010.¹⁰ Of this, 43% were public subsidies, 20% were paid by the members, and the remaining 37% were from sponsorship and gate-fees at sports events. Some of the public subsidy is generated by the public betting organization [Danske Spil]. An interesting symbiotic relation has developed between this organization and organized sports, notably soccer (see Paldam 2008).

The case of sport is probably largely demand driven. People want sport and the large number of voters involved as participants and spectators has gradually led to increased public spending in the field. However, the subsidies are more supply driven in other fields.

4.1 *The big spending programs: Paying the piper to call the tune*

State subsidies to NGOs are especially important in fields in which large public programs exist. Imagine the public budget for an x-purpose, which spends say 1-2% of GDP. Imagine further that a large NGO exists in the field.

The NGO has policies that on the one hand support public spending in the area, and

⁹ The tax wedge makes it difficult to assess the opportunity costs of voluntary work. Also it is a problem for obtaining voluntary workers in the NGOs if public employees in the same field receive a salary.

¹⁰ The total public spending on sports and leisure activities was about 4 bill in 2010. The funds finance sports facilities, compensation to top-sport, a sports hospital, etc. However, it should be mentioned that a recent estimate by DIF is that if all voluntary workers should have the going wage it would amount to 17 bill Dk.

on the other hand differ somewhat from those of the budget. If the NGO has worked in the field for a long time, it will have some expertise. This will typically give rise to an exchange of personnel, perhaps in the form of the NGO staff working as consultants for the budget, and the budget may outsource some projects to the NGO. Also, the budget will have an 'information' sub-budget, which will have funds to support the NGO, especially if it stresses the one hand and not the other.

During the process, a great deal of nice words about cooperation and the grassroots-support for the public program will be used. When the inflow of public funds starts, the NGO will expand its activity and staff. In order to increase membership, it may also decrease its membership fee, and the modest information sheet of the NGO will become a flashy journal. This, of course, calls for a larger public subsidy. Also, the public program may include special programs to cater to the NGO. In the process, the NGO quickly learns that it has to adjust if it will expand access to public funds. And, when public funds pay for most of the activity, a real dependency is created, so that the one hand will become much larger and more visible than the other.

The following are two brief case studies of expenditure programs in fields in which NGOs are important.

4.2 The ministry of the environment and its NGOs

The Danish ministry of the Environment was established in 1971, and in 2007 a separate Ministry for Energy and the Climate was created. The environment issue has a number of NGOs. The four main ones are listed in the table 3. Column (5) shows that only some of the activity reported in column (4) is financed by the members (3). The two NGOs above the dotted line are from before the Ministry was started, and would exist without public support.

The oldest of the four NGOs is DOF. Here the share of membership fees in the expenditures has dropped from 100% 50 years ago to only 19% today.¹¹ In addition to public funds, several private foundations now support 'nature', but the main part of the finances of DOF is the public subsidy. 50 years ago DOF had only voluntary workers, but now it has about 40 employees, and a handful of voluntary workers, mainly on public pension.

DN states that it does not receive public funds, and it appears largely true though it does receive a few mill Kr from funds within the public domain. The expenditure to staff is about 40 mill Kr and the staff is app 70 and about 35 part-time employees.

¹¹ The author was a member 50 years ago and he still is.

Table 3. The main environmental NGOs

NGO	(1) Founded	(2) Number members	(3) Financed members	(4) Total spent 1000 KR	(5) Share: (3)/(4)
DOF, Birdwatchers	1906	15,931	5,418	29,019	19 %
DN, Preservation of Nature	1911	133,118	59,605	90,752	65 %
WWF, Denmark, World Wildlife	1972	Not clear	19,084	52,454	36 %
Greenpeace, Denmark (14.6 % of Nordic)	1980	22,600 ^{b)}	Collections	19,600	85 %

Notes: WWF has summer/summer year. 2011 is thus 2011/12. The foundation year is for the Danish NGO. Columns (3) and (4) are in 1000 Kr.

- a. WWF mainly caters for tax deductible business sponsorships. Individual members pay Kr 360 per year.
- b. Greenpeace has activists, who collect campaign contributions, but not regular members.

The two NGOs below the dotted line are very different. Greenpeace is known for its publicity stunts at the borderline of legality, which attracts neither public nor business donors. However, Greenpeace does spend about 8 mill Kr on staff, and it employs 24 people.

The WWF is known as the ‘Official’ NGO, and it certainly does no stunts. It tries, as much as possible, to have a royal protector (in Denmark, the Prince Consort). It has a staff of 33 and 6 interns/students. It collects 19 mill Kr in fees – mostly from corporate members.¹² Also, the WWF receives about 36% of its funding from the state, mainly for its projects.

These NGOs employ almost 200 people in jobs that are registered as private jobs, though it might also be considered an extension of the public spending program.

4.3 *Danida (Ministry of Development Aid) and its NGOs*

Danida is a part of the ministry of Foreign Affairs, but it has its own Minister. Its budget for 2012 was 18 bill Kr or close to 1% of GDP. Many polls show that Danes support aid to poor countries, but it is given a low priority compared to other spending programs when trade-off items are included in the polls. Also, the aid budget is not a subject of high priority in the Parliament.¹³

Danida finances NGO-run projects in the LDCs, and it also has an information budget to inform the Danish population about the poor countries. Most of this budget finances activities implemented by a net of almost 250 NGOs in the field. Most of these NGOs are

¹² Firms are offered membership packages from between 4,300 Kr to 31,000 Kr. The home page of the WWF recommend these packages with the words (my translation): “Dependent of the sponsorship level the firm receives a set of advantages. You will network with other firms in the WWF, by participation in Elite Alliance arrangements, and at the annual reception at Fredensborg Castle with HRH the Prince Consort. The membership fee is tax deductible, and a good supplement to the CSR policy of the firm.”

¹³ The political economy of the Danish ‘market’ for development aid is discussed in part II of Paldam (1997). A great deal of statistics is reported. Though many big aid reforms have been proclaimed it is my impression that little has changed, since my book was published.

small, and the total membership is probably not above 20,000, but about 35,000 people help at the 4-5 days a year the organization runs campaigns to collect contributions.

Table 4. The four largest development NGOs

NGO, data for (2) to (4) from annual accounts	(1) Founded	(2) Number of members	(3) Financed by members	(4) Total spent mill Kr	(5) Share: (3)/(4)
Red Cross, Dk, ^{a)}	1876	Unclear	Collections	678.7	23 %
Dk Church Aid ^{b)}	1953	Unclear	Collections	528.7	31 %
ActionAid, Dk (MS) ^{c)}	1949	Ca 8000	6.2	285.3	2.2 %
IBIS (formerly WUS) ^{d)}	1970	Ca 2000	10.9	208.5	5.2 %

Notes: See Table 3. Columns (3) and (4) are in mill Kr.

- a. Red Cross also workings in Denmark, and it non-aid expenditures are perhaps 10 % not aid.
- b. Danish Church Aid started before 1953, but from 1953 it changed to aid to poor countries.
- c. ActionAid [Mellemfølgelig Samvirke] gets 1.45 mill from members and collects 4.75 mill.
- d. Latest audited accounts are from 2009, so the information used is from a few aggregate numbers. From the older accounts it appears likely that the share of membership fees in column (5) is smaller than 0.5 mill, so the number 10.9 mill given (by IBIS) appears misleading.

Table 4 lists the four main NGOs, with a combined staff of about 250 employees. They are considerably larger than the rest.¹⁴ The first two are old and have an organization that would survive even without the support from the public budget. The last two are both developed from organizations with another purpose. An unkind interpretation is that they have followed the ‘gravy trail’ to survive. Anyhow, it is obvious that they would collapse without public support.

The examples show that the big spending programs often attract the NGOs. This means that critique of policies from the NGOs becomes rather restrained. It also shows that a considerable element in the opting-in strategy of the public budgets is supply driven.¹⁵ Thus, it can be seen as a policy of building a pressure group by the distribution of rents.

4.4 Public budget coalitions

The above argument suggests that public spending programs are protected in two ways: One way is through the underlying power structure once the welfare coalition is well above 50% of the voters. It does not prevent all rationalizations and trimming programs, but it helps preventing them from being too bad, and it allows trimmed ‘branches’ to grow back. The

¹⁴ Some large organizations as the Trade Unions Movement and the Danish Women’s Organization have modest offices dealing with international affairs such as development.

¹⁵ I have several times experienced that, when I publicly criticized policies of a public budget, NGO representatives argued that the critique was bad timing relative to budget negotiations.

second way is through the opting-in of the NGOs around the programs. Instead of having NGOs as an organization that could criticize public-spending program and take the view of the public interest, they become dependent clients of the programs, almost like extensions of the PR-departments of the spending programs.

The public budgets have PR-departments much like the ones of private companies, and often they also have Sector Research Institutes with 'loyal' researchers.¹⁶ Also, they keep track of 'friendly' journalists, with whom they often develop special relationships. If the parliament approves a law that moves some expenditure within a budget, so that some subsidy recipients lose and others win, the budget staff can within a day organize a number of spots in TV and radio newscasts with deeply wounded losers interviewed by outraged journalists.

Thus, public spending bureaucracies do a great deal to control their political environment.

5. Rent absorption in the SOEs (State owned enterprises)

From the above, it would appear likely that the Danish economy may include a lot of well protected rents. The SOE sector provides rather neat examples of large rents. But, before these examples are considered, sections 5.1 and 5.2 will make a detour, to make the argument that, though the Danish economy is not as efficient as it could be, many other economies are worse.

5.1 Comparing efficiency over 60 years

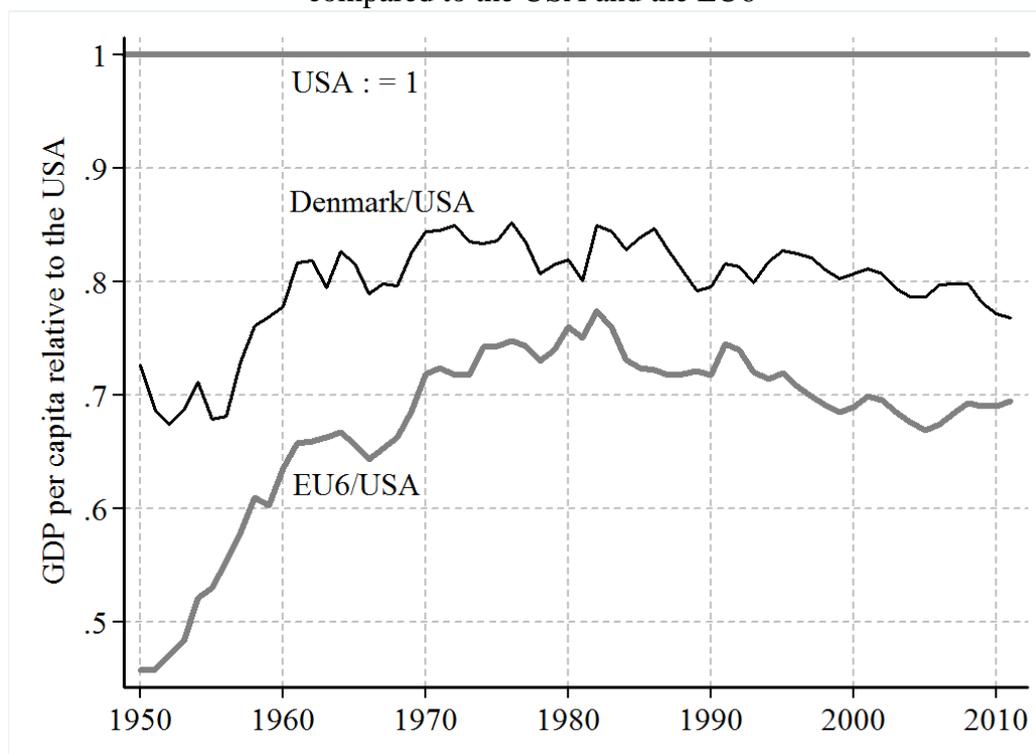
A large literature compares the GDP of different countries and makes lists of the countries that are ahead on one scale or another. Figure 2 is a basic version. It compares PPP-GDP per capita with the one of the USA and average of the original 6 EU countries. The figure shows that for the last 40 years rather stable long-run gaps have existed among the three groups.

The two main reasons for the efficiency gap are (a) lower technology and (b) inefficiency generated by protection and bad regulation.

From 1950 to 1970, the figure shows the big catch up after the Second World War. Since then, Denmark has been at 85% to 80% of the US GDP-level, while the EU-6 has been about 10 percentage points lower.

¹⁶ The first rule of research ethics is that sponsors, with any 'interest' in the results reached, should be mentioned in the first note of the paper. In Denmark this is strictly applied to private sponsors, but not to public sponsors, maybe for the reasons mentioned in the second paragraph of section 1.1 above.

Figure 2. The relative effectiveness of the Danish economy compared to the USA and the EU6



Note: The EU6 countries are Belgium, France, Germany, Italy, Luxembourg and Netherlands. The weight used to calculate the EU6-series is their average share of the joint GDP, so Luxembourg does not count in the average. The curves are made by dividing the GDP per capita with the one for the USA
 Source: Maddison (2003) updated to 2011 by the PPP-series in WDI.

The European countries have lost about 5 percentage points to the USA since the early 1980s.¹⁷ Thus, the Danish economy is rather efficient by European standards. In fact, apart from offshore financial centers as Luxembourg, Lichtenstein, Monaco and Switzerland,¹⁸ no European country has been consistently richer. Sweden has a fairly similar path (and so has Canada), while Norway used to be poorer, but it is now richer, because of oil.

Economic theory suggests that it is the size and competitiveness of the domestic market in the USA that has made its economy so efficient. In Europe a large effort has been made to open a similar sized market. It has been rather successful, but not quite as successful as the US.

5.2 The efficiency/welfare trade-off

In the last decade, Sweden has been overtaken by Denmark as the most developed welfare

¹⁷ Note that Denmark did relatively well from 1995-2008, but has lost this edge during the latest crisis. It is much discussed in Denmark if this points to a permanent problem.

¹⁸ The excess wealth of safe havens is analyzed in Christoffersen *et al* (2013) and Paldam (2013).

state, and it certainly has the highest tax pressure. It is commonly believed outside Scandinavia that Denmark is a socialist country but this is wrong.

In order to finance the welfare state, Denmark has a strict protection of property rights and a strong tradition of free trade.¹⁹ One may even say that the extreme size of the welfare state is balanced by an equally extreme ‘liberalism’ in the private sector. Denmark has no SOEs (State owned enterprises) within trade, industry, agriculture and finance.²⁰ There has even been a fairly strong movement for outsourcing of traditional public production to private firms.

Christoffersen and Paldam (2003) studied the degree of outsourcing by the Danish municipalities. It turns out that the traditional Left/Right factor has no influence on the degree of outsourcing. However, the size of the welfare coalition in the municipalities has a substantial negative effect.

Figures 3a and b looks at the Fraser Economic Freedom index for same countries as figure 2, though only from 1970, where the index starts. The index aims to measure the regulation regimes of countries. It gives 10 points for laissez faire. This falls to 1-2 points in extremely regulated states with no freedom to run a private business, such as in the communist bloc before 1990.

It is not surprising that the USA has more economic freedom than the European countries, and one may also have expected to see the fairly large liberalization from 1985 onwards in the (old) EU-countries. It is probably surprising to see that Denmark since 1990 has moved to a position between the USA and the EU6-countries.

The Fraser index has 5 components.²¹ Denmark has low values for the component of the ‘size of government’, but scores rather highly in the other components, notably ‘the freedom to trade with foreigners’, and (absence of) ‘business regulations’, even at the period from 1975 to 1990 (see Christoffersen *et al.* 2013, chapter 2.5).

When figures 2 and 3 are compared, it is obvious that there is a connection – the more economic freedom, the wealthier is the country – but it is also clear that the connection is less than perfect. This corresponds rather well to the findings in the literature (see, for example, de Haan 2003).

¹⁹ See Bjørnskov and Paldam (2012) for an empirical study of the public support for capitalism versus socialism. The support for capitalism is fairly high in Denmark.

²⁰ See Köthenbürger *et al.* (2006), for detailed comparisons of the SOE sector in the EU countries. The Danish SOEs are in the network industries and certain traditional services as Post and Betting. The only big privatization since 1990 has been the telephone company.

²¹ The five components are: (C1) Government size (-); (C2) Legal quality (+); (C3) Sound money (+); (C4) Freedom to trade with foreigners (+); and (C5) Regulation of business (-). The signs in ()-brackets shows the way the variable affect the index. Denmark has high scores except for (C1).

Figure 3a. The regulation regimes of the USA, EU5 and Denmark according to the Fraser Economic Freedom Index

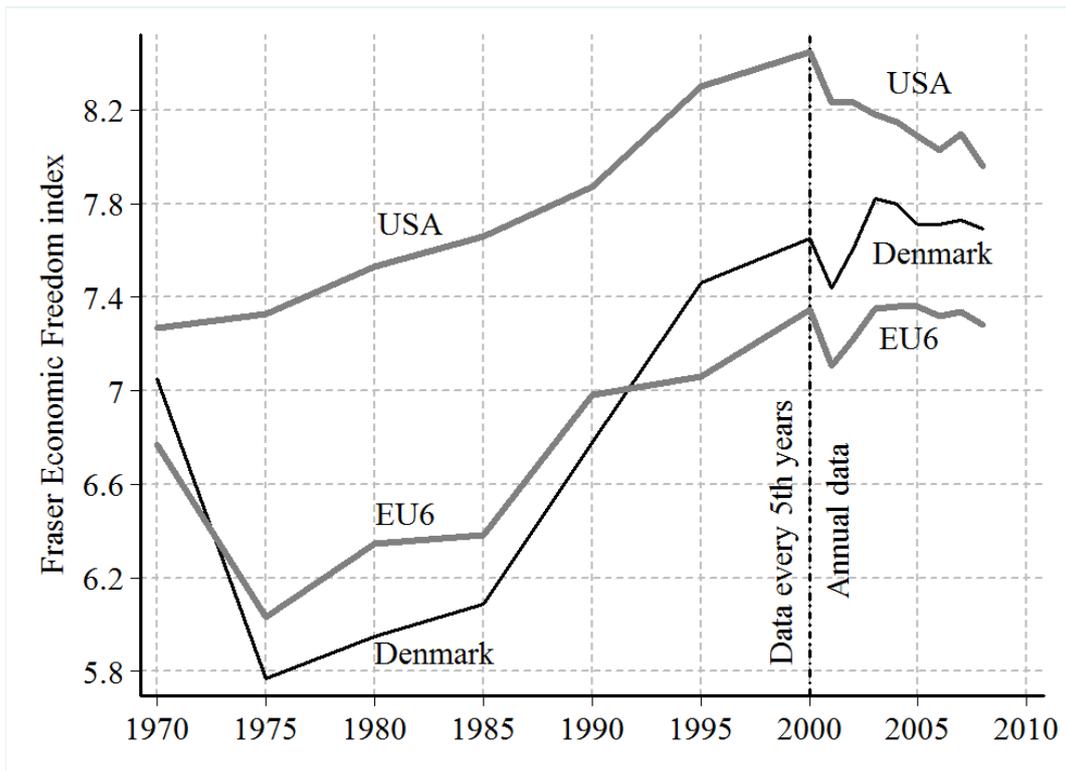
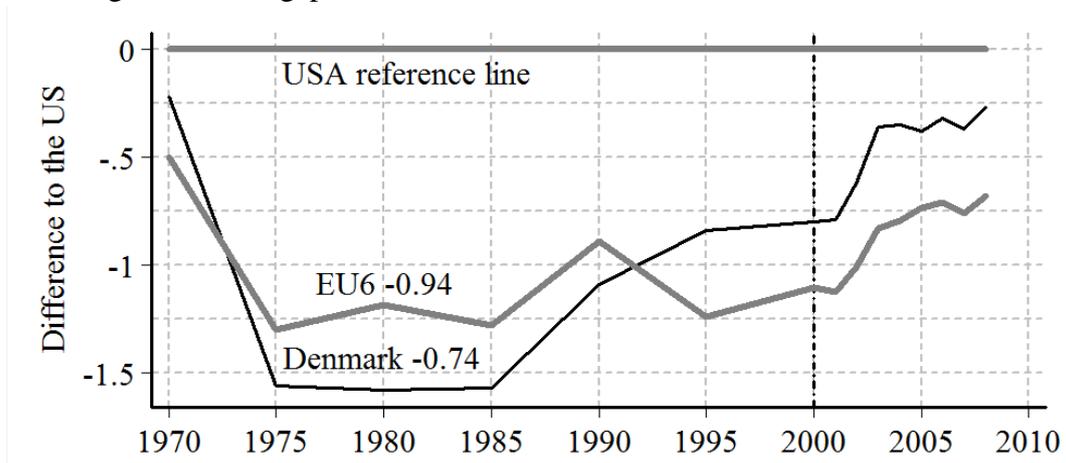


Figure 3b. The gap between the USA, Denmark and the EU6 countries



Note: The values compared are the chain-weighted aggregate index. The EU6 and Denmark lines of Figure 3b are calculated from the data for Figure 3a by subtracting the USA-data. The two numbers given, -0.94 and -0.74, are the average deviations from the USA. Source: Fraser Institute Homepage.

The two reasons for the 20% gap in efficiency between the Danish and the US economy mentioned above were: (a) lower technology and (b) a more sluggish economy due to excessive rents from protection and bad regulation. It is not easy to compare the technology

levels. The attempts at comparison in different fields seem to find only a small systematic difference, mainly because the US does have the world's most advanced technology in some fields, but then there are rather large pockets of fairly low technology. One can suggest that most of the efficiency gap is due to unproductive rents in the protected part of the economy. That is mainly in the public sector – notably in the protected semi-public sector.

5.3 Rents in the SOE-sector: Transport

The network industries tend to have a natural monopoly. Hence, they have to be regulated. The two examples given are from the two largest transport SOEs. The welfare state wants collective not private transport, so Danish car taxes are the highest in Europe. This gives air and rail transport a large competitive advantage. Both fields have a large SOE: SAS in the air and DSB on rail.

There is no reason to have monopoly in the air, but for long Europe had a system of national airlines where most routes were protected from competition. The typical fares were 2-3 times those for similar distances in the USA. One of these airlines was the SAS that is jointly owned by the three Nordic countries, so it was a triple sheltered public service. But then the market was liberalized and the pampered family of national airlines started to suffer: Airfares dropped and big rounds of cost cuts were made to prevent bankruptcies.

When the crunch came, the SAS managed to reduce costs by about 50%. Thus the SAS managed to absorb rents in the order of 50% in the last 2-3 decades before the EU enforced competition. The salaries and frills of pilots were just like those that we all believe that we deserve! The SAS ran sales offices at the Place Concorde, Kurfürstendamm, etc. No expense was too high to secure the absorption of the high ticket prices.

The DSB [Danish State Railways] is an old public monopoly that was formed in 1885 after the collapse of several private rail companies, and over the years it has developed its own company culture. Since 2000 a couple of attempts have been made to introduce competition, and some minor lines (with some 6% of the passenger traffic) are now run by the British company Arriva, which managed to operate with a profit. However, DSB still handle 94% of the Danish rail passengers.

In the last 20 years, the DSB has built a reputation as having an extraordinarily poor company culture. Frequent deficits (kr 858 mill in 2011) have accumulated rapidly to a debt of 18 bill Kr. DSB is also known for an amazingly high wage level. In January 2013 it was revealed that the salespersons walking the trains with a trolley had a higher salary than a high school teacher, and lo and behold, the trolley sales had large deficits. Similarly high salaries

seem to prevail for other staff. The business culture is illustrated by the story of two spin-off companies:

In the late 1990s many bus lines was outsourced after competitive bidding. In order to join the bidding, DSB turned its modest bus company (DSB Bus) into a limited liability company named COMBUS in 1997. It did win a lot of lines by very low bids, and for a short period it was the largest bus company in the country. But it ran most of the lines with a deficit, and already in 1998 the company had consumed most of its equity capital. Both in 1999 and 2000, the State supplied new equity capital, but it gave up in 2001, where the company was sold for a price of 100 Kr to Arriva.

DSBfirst was a company formed in 2009 by DSB and a private British rail company (FirstGroup) to run rail traffic in Southern Sweden and NE-Zealand. FirstGroup managed to leave the company in 2011. Though the final accounts are not in, it appears that it has managed to lose close to 1 bill Kr since its formation.

In addition to these accounts, a 5 bill Kr contract was signed in 2000 with the Italian company AnsaldoBreda for 83 new trains to be delivered before 2005. The last trains were delivered in 2013, but they rarely work. There were never more than 10 of these trains actually running on the Danish rails at any time, and it increasingly looks as if the DSB has given up on the majority of the trains. How the blame for this business tragedy should be distributed between AnsaldoBreda and DSB will probably be discussed for a good many years.

5.4 Culture: The amazing story of the Danish Radio and the Royal Theater

The Ministry for Culture and Sport had budget of 20 bill (10⁹) Kr in 2011 – local governments spend another 2 bill. The Ministry runs two large SOEs that consume a lot of taxes.

DR is a Radio and Television SOE, with just above 3,000 employees. This is almost the same as the workforce in all the private newspapers added together. DR has special permission to levy a media tax of 4 bill Kr, of which about 12% is passed on to other media via the ministry, but, as DR has some other income, its balance is also about 4 bill. In its public accounts it is stated that it owns real estate of a value of 5.3 bill. This is mainly the grand ‘DR town’, which is a complex of buildings erected between 1999 and 2009 on a former seabottom close to the center of Copenhagen. The project involved a ‘decision complex’ of the Parliament, several ministries, Copenhagen municipality and the DR top management. Everybody in the complex is within the welfare coalition, and, of course, so is DR.

The DR town was originally proposed by the DR management in 1995-7 as a modest

project that could be built from the sales revenue of the previous old buildings, and it was stressed that it would be a big rationalization to move the staff from the scattered old buildings together under one roof! This proved to be one of the sweet songs foxes sing to woo chickens.

Once the decision had been accepted by the complex, the costs and size of the project started to jump. When the design of the architects was in, the scheduled costs had reached 3 bill, and the expected sale revenue for the old buildings had almost evaporated. Then the project started and before it ended in 2009 the costs went to about 4.5 bill. It did cost about five members of the senior DR management team their job, but some of them would have retired anyhow over the 10 years of the project.

I am convinced that if the costs and size of the project had been clear from the start, it would never have been accepted. I also suspect that everybody in the decision complex knew that there would be large cost overruns. Also, of course, the private newspapers and the center-right government (from 2001 to 2011) were critical,²² and the DR was repeatedly forced to promise that it would save on the rest of the budget. However, the last budget (covering the 5 years from 2007 to 2011) shows that it has kept rising with 2% per year, though total employment has an unclear trend.

One perspective is that DR is a key part of PR-apparatus of the welfare coalition, and that it has so many friends/clients within the power structure that it has been allowed to proceed with the building of premises that fit with its importance. Also, it has successfully argued that the construction costs are sunk, so that they should have no consequences for future budgets.

The case of the Royal Theater is curiously parallel, in the sense that also this SOE has increased its real estate dramatically since year 2000. Before 2005 the theater had two stages – this has now doubled. In 2005 a private donor (Maersk Foundation) donated a new opera house (to 2.4 bill Kr). While it was being built, the government decided, with virtually no public discussion, that it should also give the theater a new building (to 0.8 bill Kr) with a stage for theater performances. It was inaugurated in 2008, and at that time the smaller of the two old stages was closed, but the number of seats had still increased about 3 times. It is interesting that neither of the two new buildings had any cost overrun. Now the theater is seeking an increase in its subsidies to tally the increase in seats.

²² It has often been alleged that the DR-staff is to the left of the political center, and it is easy to point to left wing journalists working in DR, but it is difficult to prove that they dominate. However, in the perspective of the welfare coalition it is clear that DR is the part of media that is within the public sector.

The public budget supports theaters with 1.5 bill Kr. Half of this sum goes to the royal theater, which has operating costs of 850 mill of which 130 mill is covered by the sale of tickets. Some money comes from private sponsors. The three theater-buildings are all written off, so they are invisible in the accounts, but the annual opportunity costs of the three expensive pieces of real estate must be several hundred mill Kr.²³ So the rent-wedge between the business income and costs is about 8. The Royal Theater was founded in 1747. As far as I have been able to find out, the rent-wedge was below 2 a hundred years ago. So the theater has managed to grow in size and has managed to obtain a steadily increasing rent-wedge.

The Royal Theater has a fine statement expressing its goals and values. It provides benefits to the nation and mankind through the art of theater. As may be expected, no mention is made of any vulgar economic matters such as costs. At the risk of being grossly vulgar, one could consider the story of the Royal Theater as a case of a special institution that manages to extract steadily increasing rents. There are other theaters in the country with far smaller rents. The majority of those harvesting rents in the form of cheap tickets seem to be members of the welfare coalition.

5.5 *Danish SOEs are like other SOEs, but fortunately they are few*

Many studies have been made of SOEs around the world. Some such stories and a good deal of references are given and in Köthenbürger *et al.* (2006). There is also a large literature on the relative costs of outsourced and public production of similar goods and services (see Christoffersen *et al.* 2007). Denmark is typical in both respects. That is, Danish SOEs extract as much rents as they can, i.e., SAS charged the same high prices as other national airlines, when it could. DSB is not more inefficient than other public railway monopolies, etc. Also, the studies of outsourced services in Denmark show much the same efficiency gains as in other countries.

The observation in section 5.1 that the Danish economy is fairly efficient thus tallies well with that of section 5.2 that there are relatively few SOEs in Denmark.

6. Conclusion

This chapter is about rent extraction and also rent seeking in the public sector in the most developed welfare state in the world. The rents are relatively well protected, as the median voter is within the informal ‘welfare coalition’ of those who benefit from the welfare state.

²³ This is a tricky calculation as the three buildings are made precisely for the purpose they are used for. So an assessment demands that the buildings are malleable.

The welfare state has built a protecting ring of NGOs around its main spending programs. On the face of it, one should expect that big rents exist in the welfare state.

The comparison of the efficiency of the Danish welfare state with the USA showed that Denmark is 20-25% behind. My assessment was that the difference in technology level is less than half of this difference. Most of the rest of the gap is explained by inefficiencies associated with rents. The USA is surely not a society without rents, so rents are substantial in the welfare state. A number of cases in which policy changes caused rents to be visible were given. In these examples rather large rents were revealed.

However, with all of this, it still appears that the Danish economy is rather efficient compared to other European countries, and, although the measure of happiness must have some measurement error, the very high Danish happiness scores have been replicated so often that it is clear that the Danes are very satisfied by their life. And they certainly like their welfare state.

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