THE HUFFINGTON POST

To Grow the Welfare State, Keep It Small

By: Dalibor Rohac- June 18, 2013

Libertarians have been having a bit of a love affair with Nordic countries. Notwithstanding their high levels of redistribution, Nordic economies rank among of the world's freest - mostly due to their light-touch regulation and a legacy of large-scale pro-market reforms in the 1990s.

One of the things that make Nordic countries tick are their civic virtues. Scott Sumner, an economist at Bentley University, cites data from the World Values Survey, which indicate that Danes are more likely than any other nationality to find it unacceptable to claim government/state benefits to which they have no rights.

High levels of trust and willingness to cooperate make it easier to sustain redistribution. But how to explain these cultural traits? Two factors seem relevant: homogeneity and size. Clearly, homogeneity along different margins - cultural, ethnical, religious - reduces social distance and makes people more prone to cooperate, for example, to provide public goods.

It's not difficult to see where that idea can lead. In his forthcoming book on immigration, Paul Collier, a development economist at Oxford University, blames increased cultural diversity for an alleged decrease in support for redistribution in the West:

Despite the growing need for redistributive policies, actual policies have shifted in the opposite direction. Not only has there been a drift to lower taxation of incomes. More subtly, many goods and services which used to be supplied through the government are now supplied through the market. Michael Sandel has brilliantly anatomised this process, which since the 1960 has shrunk the role of the state and thereby contributed to rising inequality.

Many influences contributed to the policies of reduced taxation and increased reliance on the market, not least that of the economics profession. But the pronounced increase in cultural diversity brought about by immigration my have been one of them.

Among other sources, Collier cites a paper by Harvard economists Alesina, Glaeser, and Sacerdote, who find that higher level of racial heterogeneity in the United States may explain its lower level of redistribution compared to European countries. That leads him to conclude that immigration restrictions are desirable:

At minimum, the task for migration policy is to prevent its acceleration to rates which would become damaging, both for those left behind in poor countries of origin, and for the indigenous people of host countries.

A couple of things seem odd about the argument. Why, for example, pro-market reforms occurred in homogenous societies - like the Nordic countries in the 1990s or New Zealand in the 1980s - and were often more radical than those in the United States or the United Kingdom? How come - if the role of government has shrunk - the public debt of Western nations is growing at rates that are not sustainable?

Let us ignore these problems and assume that Collier and others are correct in asserting that cultural diversity decreases the willingness of people to cooperate -resulting in lower levels of government redistribution. And let us also assume, for the sake of the argument, that more redistribution is desirable.

But even if we accept those two premises, limiting migration seems as a non-sequitur as long as size - and not just homogeneity - affects the willingness to cooperate. Small size, or proximity, is relevant because it makes personal interaction more likely and forces people to get along by sheer necessity.

Instead of limiting migration, policymakers always have the option of decentralising redistribution - without the huge economic cost that immigration restrictions entail. As a result, redistribution that could not be sustained in large diverse societies can still take place at a lower level of government.

The idea that the 'nation-state' is the only possible node of redistribution is unwarranted, if only because of the sheer multitude of political entities hiding behind that term. Clearly, running a pay-as-you-go pension scheme in the 1.34-million Estonia cannot conceivably be the same thing as running a pay-as-you-go pension scheme in the United States, with a population of 314 million, or in India, with its 30 languages that are spoken by more than a million native speakers.

If policymakers want to redistribute income through the political process in the face of increased diversity, they have to bring the relevant nodes of redistribution closer to people. Instead of Obamacare or the UK's National Health Service, they ought to be pushing for state-level or regional healthcare systems - as well as for decentralised forms of welfare assistance.

There is little evidence for economies of scale in redistribution - after all, small welfare states seem to fare quite well. Moreover, 'redistribution' is not a simple scalar variable - instead, it is a catchphrase for a multitude of complex policies in different areas, with very little consensus among experts or laymen on what the best bundle of policies is. That only strengthens the case for decentralisation, institutional competition and institutional learning.