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Three Swedish Models*

There has been much talk, in Sweden as well as internationally, about a so-called Swedish economic model. But it is misleading to refer to one *single* economic model in Sweden. The economic system in Sweden has varied a great deal over time after the (late) industrial revolution in the second half of the 19th century. Although it is hazardous to divide the economic development in a country into different historical periods, it may be instructive to differentiate between three periods in Sweden – and hence three different Swedish models.

The market-oriented model 1870-1970.

The economic system in Sweden during the first century-long period from about 1870 to 1970 may be called *the market-oriented model*. It is hardly controversial to date the start of this period to about 1870 – shortly after the new legislation about the freedom of entrepreneurship ("näringsfrihet") in 1864 and Sweden's membership in the European free-trade act a year later. During most of this century-long period, government intervention in the national economy mainly consisted of the provision of fairly stable rules of the game, a basic responsibility for the bulk of the infrastructure (roads, railways, harbors, mail and telecommunication), a modest safety net, in particular in connection with work injuries and high age (a modest pension from the government) and the provision of basic human services such as simple health care and compulsory schooling (the latter, in fact, already from 1842). As we know, the market system in Sweden, as well as in other Western countries, was subsequently combined with gradually more ambitious social arrangements (welfare-state arrangements).

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* Lecture for conference in Stockholm August 2009, arranged by the Mont Pellerin Society. I have extended the statistics in some figures by two additional years. I have earlier referred to three Swedish models in my article "Lessons from Sweden for Post-Socialist Countries" in J. Kornai, S. Haggard and R Kaufman (eds.), *Reforming the State. Fiscal and Welfare Reform in Post-Socialist Countries*, Cambridge University Press and in an article, "The Three Swedish Models "in international newspapers in the context of Project Syndicate (30/5 2007).

Characterizing the economic system in Sweden during the period 1870-1970 as "market-oriented"does not mean that the system had the character of a "laissez-fair" economy. It is in comparison to the following decades, mainly the period 1970-1990, that it is reasonable to use the term market-oriented for the economic system during the century-long period 1870-1970. Generally speaking, we may say that the economic system in Sweden was broadly similar to the systems in other Western European countries – including the levels of public spending and taxes – until the second half of the 1960s or the first half of the 1970s. The economic growth rate (per person) in Sweden in this period was one of the fastest in the world, perhaps the very fastest, on approximately the same level as Japan and Canada.

The interventionist model 1970-1990

It is not obvious how to determine when the market-oriented period ended, since there were gradual changes in the economic system. I have chosen to date the end of the period to about 1970, considering the *total sum* of important changes in the economic system in the second half of the 1960s and the first half of the 1970s. I refer, for instance, to the huge increase in public expenditures, from 30 percent of GDP in 1960 to 40 percent in 1970 and to more than 60 percent by 1980; see Figure 1. There was also an increase in public-sector spending as compared to other rich countries, although the statistics in Figure 1 exaggerate the difference in the sense that transfer payments are more often taxed in Sweden than in some other countries. The government ambitions to even out the distribution of disposable income during the 1970-1990 period were reflected in the 1970/71 tax reform with a considerable increase in the marginal tax wedges (Figure 2).[1] There was also a drastic increase in the real tax rates of capital income for small firms at about the same time (Figure 3). Other expressions of increased public interventions in the national economy are the increase in public ownership of real capital (mainly housing) and financial capital (mainly the government-operated pension funds) and the new legislation of job security in 1973. Labor unions increased their ambitions to even out the distribution of labor income, at the same time as the profits of firms were squeezed. Moreover, the future role of private entrepreneurship in Sweden was challenged when politically powerful labor union organizations (in particular the central organization for manual workers, LO) and the Social Democratic Party launched a serious proposal during the period 1975-1982 to shift the ownership of firms to collective "wage-earner funds" under the

[1] Figures 2 and 3 are based on calculations by Gunnar du Rietz.

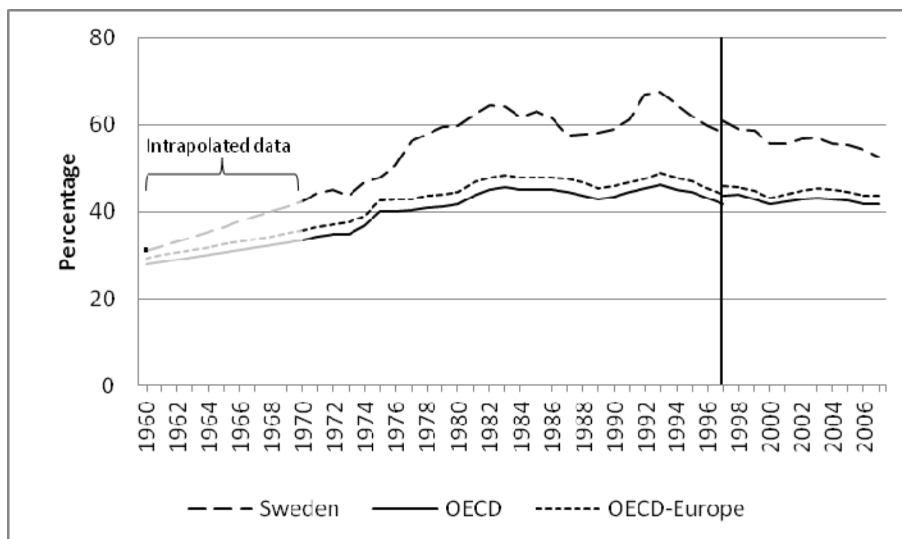
control of the unions. As a result of changes of these various types, the economic system in Sweden started to deviate considerably not only from earlier times but also from the economic systems in other developed countries. These are the main reasons why I have chosen to denote the period 1970-1990/(95) "the interventionist period".

In this lecture, I will not try to explain Sweden's gradual shift from a market-oriented to an interventionist model. It is likely that the international ideological leftist winds that started in the mid-1960s played a part. But it then remains to explain why these winds had stronger effects on policies in Sweden than in other countries. Another conceivable explanation for the rapid increase in government spending and the redistribution of income in Sweden may be that organized pressure groups were quite politically strong in Sweden during that period, and that they also had a pronounced political agenda – reflected, for instance, in the demand by some labor unions for strict job-security legislation and "wage-earners' funds".

Compared to other rich OECD countries, the GDP growth rate in Sweden was relatively weak during the interventionist period (Figure 4). GDP per person lagged by 12 percent between 1970 and 1990 (two boom years) as compared to other rich OECD countries. It lagged by 16 percent between 1970 and the crisis year 1995. The reason why there was no recorded lagging behind during the 1980s is that the capacity utilization of the economy during the second half of that decade was pushed up to unsustainably high levels (with open unemployment as low as about 2 percent), which contributed to high inflation and subsequently a deep recession in the early 1990s.

It is a complex issue to determine the factors behind the relatively weak growth of Swedish GNP during the period 1970-1990(95). Some observers have referred to the structural crisis that hit Swedish manufacturing in the mid 1970s, as a result of increased international competition, in particular for the large steel and shipyard industries. However, it is not obvious that Sweden has been hit by increased international competition and related structural crises to any larger extent than other countries. Observers trying to explain the slow rate of increase in per capita GNP during the period 1970-1990 have also referred to mistakes in stabilization policy. However, nobody has shown that such mistakes have been more serious in Sweden

Figure 1. Public spending in percent of GDP 1965-2010.



Data extrapolated for the years 1961-1969. OECD excluding Chile, Denmark, Finland, Greece, Hungary, Iceland, Israel, South Korea, Luxemburg, Mexico, New Zealand, Poland, Portugal, Slovakia, Slovenia and Turkey.
Sources: General Government Accounts, OECD; Tanzi and Schuknecht (2000) - "Public Spending in the 20th Century: A Global Perspective".

Figure 2. Marginal tax wedges 1945-2010.

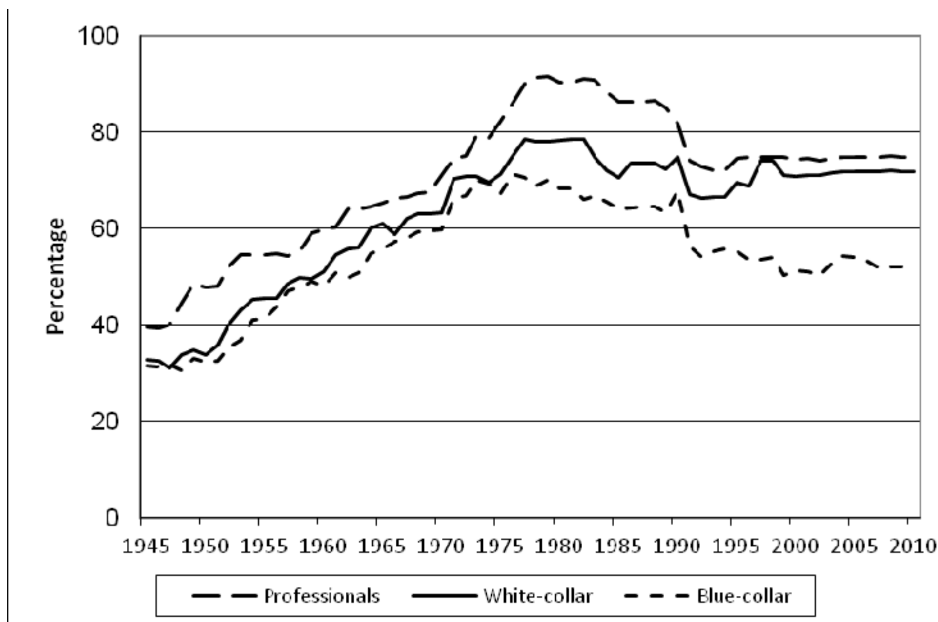


Figure 3. Real tax rates for small firms 1965-2010.

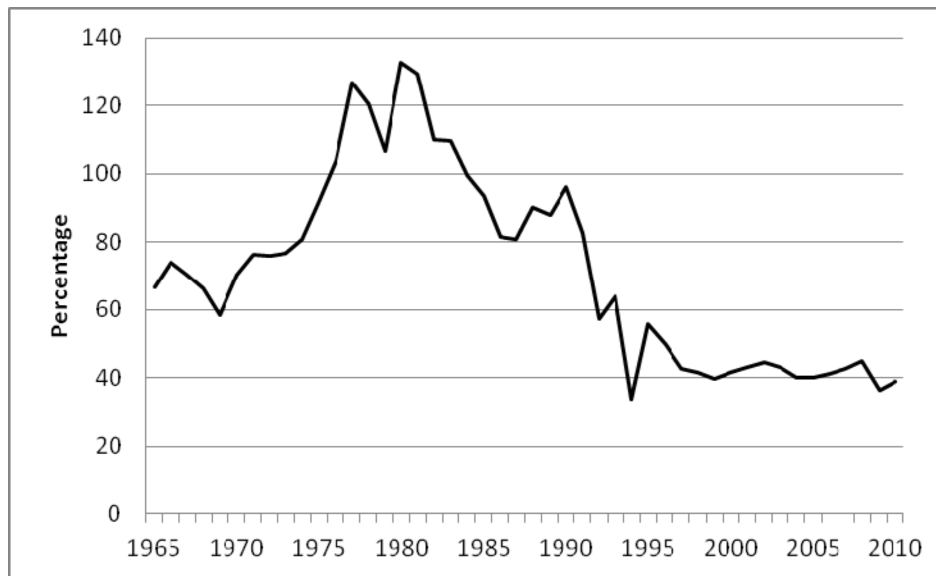
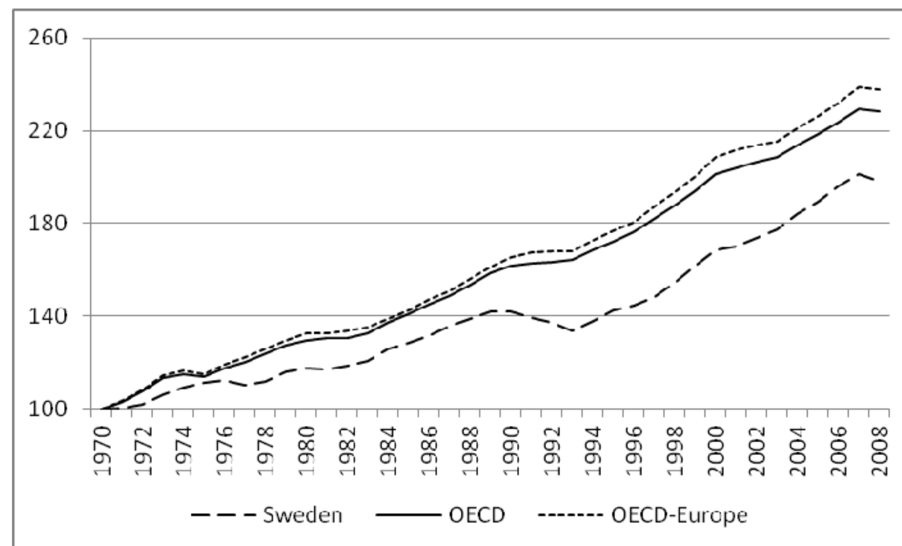


Figure 4. GNP Growth 1970-2010.



OECD excluding Chile, Hungary, Israel, South Korea, Mexico, Poland, Portugal, Slovakia, Slovenia and Turkey.
Source: National Accounts, OECD.

than in other countries. It is more likely that the well-known “catch-up” factor helps explain Sweden’s lagging behind. Countries with initially relatively low productivity are sometimes able to catch up with high-productivity countries by importing advanced technology and organization from the latter countries. However, this can hardly explain why a number of countries did not only catch with to Sweden but also passed us.

Several Swedish economists, including myself, have argued that the changes in the Swedish economic system between the mid-1960s and mid-1980s are likely to be important factors behind Sweden’s relatively weak economic performance during the 1970-1990(95) period. What we then refer to is that the role of markets, economic incentives and private production initiatives shrank during this period, at the same time as the proposals for “wage-earners’ funds” created an uncertainty about the future role of private ownership of firms in Sweden; the decision to actually create such funds, although in a somewhat watered-down version, was taken by parliament in 1982.

It is likely that the build-up of a generous welfare state in Sweden during the first decades after World War II was, up to a point, fully compatible with an efficient and fairly rapidly growing national economy. But, in my view, it is also likely that Sweden overshoot this point during the interventionist period. I then mainly refer to the government’s monopolization of the production and provision of human services (such as child care, education, health care and old-age care) and the high marginal tax wedges, including the particularly high implicit tax wedges for individuals who consider living on work rather than on various types of transfer payments. Individuals contemplating to work rather than living on benefits from various social insurance systems were in fact often exposed to implicit tax rates of 80-90 percent – or even more.

The period of partial liberalization

The interventionist period was followed by what may be called a period of *partial liberalization*. The process started modestly at the end of the 1980s by the removal of exchange control and of the regulation of international capital movements. The liberalization process continued with a large tax reform in 1990/91 including considerably reduced marginal tax rates (Figures 2 and 3) – decisions taken in a period with a social democratic government. From the fall of 1991, the process was followed up by a non-socialist government through the

rewinding of the "wage-earners' funds" and deregulations in a number of production sectors, such as the transport system (trucks, buses, taxis and air transport) and the energy system. The non-socialist government also made it possible for private institutions to compete with public-sector institutions for providing social services such as child care, schools, health care and old-age care. This was achieved by paying government subsidies for such services regardless of whether they are produced by government authorities, cooperative organization or private agents. During the 1990s, a new pension system was also developed – with a stronger tie than in the previous system between paid contributions and expected future pension benefits; hence with stronger incentives for individuals to work during their life cycle. Moreover, during the period of non-socialist governments from 2006, the wealth tax was removed (after the inheritance tax had been removed under a social democratic government). There has also been a gradual reduction in public spending as a share of GNP – from above 60 per cent in 1990 to above 50 percent – and reduced taxes from 51 to 45 percent of GNP.

There were also some modest changes in the labor market. In particular, wage formation became more decentralized in the sense that bargaining was moved down from a highly centralized level to the branch level, with an increased tendency for individual wage setting, in particular for white collar employees.

Generally speaking, the reform of the economic system in Sweden that started in the late 1980s and early 1990s may be characterized by decentralization, an increased reliance on markets, more private ownership of real and financial assets, stronger economic incentives, increased competition and increased freedom of choice for citizens, in particular for the case of human services and infrastructure services. At the same time, the internalization of the national economy continued; for instance, the export share is now no less than 50 percent of GNP.

In a similar way as when the international leftist ideological wave in the late 1960s stimulated government interventions in the national economy during the 1970s, it is likely that the international "liberalization wave" in the 1980s and 1990s constituted an important background to Sweden's partial liberalization of the economic system from the end of the 1980s. However, most likely, the disappointing economic performance of Sweden in the interventionist period was another important factor behind the partial liberalization of the Swedish economic system in the last two decades. Indeed, both a number of individual

Swedish economists and a number of Government commissions, including the so-called Bjurel-delegation in 1979 and the so-called Lindbeck-commission in 1993, contributed to spread the message that Sweden had much to gain from a return to a more market-oriented economic system with a stronger role for economic incentives.

Another presumably favorable factor for the development of the Swedish economy, as compared to a number of other countries, is that fiscal and monetary policies since the late 1990s are more rule-based than earlier. The budget process is much stricter than before, with stronger requirements for budget discipline than earlier. This is reflected in a predetermined level of maximum aggregate spending by the central government, targets for the budget balance and serious concern for the ratio of public-sector debt relative to GNP. In the case of monetary policy, the discipline has been enhanced by a shift to an operationally independent central bank with a strict target of low inflation (two percent plus/minus one percent).

As a mirror image of the prediction of negative effects on economic efficiency and economic growth of the increased government interventions during the period 1970-1990(95), it is natural to expect more efficiency and faster economic growth as a result of the subsequent partial liberalization of the national economy. However, it is likely that improved long-term economic performance only emerges after some time lag. Broadly speaking, it seems that Sweden has by now regained the loss in GDP growth during the deep recession in the early 1990s but only a modest fraction of the loss between 1970 and 1990. It is too early to tell if Sweden will be able to return to its relative position in 1970 as one of the four richest countries in the OECD area.