PROJECT SYNDICATE
AN ASSOCIATION OF NEWSPAPERS AROUND THE WORLD

The Three Swedish Models

Assar Lindbeck

Assar Lindbeck

Sweden's economic and social system, sometimes called the "Swedish Model," is often depicted either as an ideal or an abnormality. But Sweden's system has varied considerably. In fact, broadly speaking there have been three different Swedish "models" since the late nineteenth century.

The first model lasted from about 1870 until the 1960's. During this "liberal" period, the government basically provided stable market-supporting legislation, education, health care, and infrastructure. As late as 1960, both total government spending (as a share of GDP) and the distribution of earnings were similar to those prevailing in the United States. During this century-long period, Sweden moved from being one of the poorest western countries to being the third richest country in terms of GDP per capita. In other words, Sweden became a rich country *before* its highly generous welfare-state arrangements were created.

A second era lasted from 1960 until 1985. The free-trade regime of the liberal period was retained during this period – indeed it was deepened by the various rounds of global trade liberalization – but the dominant thrust was the creation of a generous welfare state. By the late 1980's, total public spending reached 60-65% of GDP, compared to about 30% in 1960. Moreover, marginal tax rates hit 65-75% for most full-time employees, compared to about 40% in 1960 (all taxes on households being included).

Economic incentives to work, save, and start businesses were also reduced through the compression of wage differentials and a big squeeze on company profits, both largely the result of strong and centralized labor unions. Moreover, new labor-market regulations

were introduced, the most important being strict job-security legislation implemented in the early 1970's. The regulation of financial markets that was imposed during WWII was retained. It is this economic and social system that is usually identified as the "Swedish model."

Although economic performance during this period was not dismal, it was certainly not impressive. Between 1970 and 1995, GDP per capita in Sweden lagged by about 18% behind the average of rich OECD countries. As a result, Sweden fell from third to approximately seventeenth place in the OECD in terms of GDP per capita. This can partly be explained by the "catch up" mechanism, as technologically less advanced countries imported technology from more advanced countries. But this does not explain why 14 countries not only caught up with Sweden during this period, but *surpassed* it in terms of GDP per capita.

The removal of capital-market regulations and foreign-exchange controls in the late 1980's, and Sweden's entry into the EU in the early 1990's, signaled a new era – the embryo of a third Swedish model. In 1991, marginal tax rates were cut by 10-20% for large parts of the population. These reforms had broad political support and were, in fact, initiated during a social-democratic government. Subsequently, mainly during a period of center-right governance, several product markets were deregulated: telecommunications, electricity, road transport, taxis, and, to some extent, railways.

A process of deregulation and privatization, although with continued tax-financing (in fact, basically a voucher system), began in the field of "human services," in particular for childcare, education, and old-age care. One purpose of this was to increase competition and freedom of choice.

Partly in response to these reforms, Sweden's growth rate picked up from the mid 1990's, and today about a third of the previous lag in GDP per capita since 1970 (as compared to other developed countries) has been recovered. However, Sweden is still characterized by high welfare dependency, with about 23% of working-age people in recent years living on various types of government benefits, including temporary and permanent disability payments.

The new center-right government elected in the fall of 2006 has committed itself to continuing economic liberalization. The government has announced plans to privatize state-owned companies, improve conditions for small firms, and continue increasing individual freedom of choice in the case of human services. It has also abolished the wealth tax (after the previous social-democratic government had already abolished the inheritance tax).

Moreover, the government has modestly reduced taxes on wages and slightly scaled down the generosity of some benefits. One argument for the latter policy is to improve the government's budget, another to make work more economically rewarding relative to government benefits.

Indeed, in important respects today's Sweden is moving back to the liberal economic regime that existed before the explosion of government interventionism in the 1960's. But there are two basic caveats. First, all political parties agree that welfare-state arrangements should remain tax-financed, although possibly with a stronger application of insurance principles in the social insurance systems. So even if the generosity of state benefits may be curtailed, aggregate government spending is unlikely to be rolled back dramatically from the current 53% of GDP.

Second, there is general agreement that the government should take more active responsibility for environmental issues, although policies in this area increasingly rely on market instruments (prices for environmental disturbances) rather than on quantitative regulations

Clearly, some of these policy measures may conflict with traditional egalitarianism in Sweden, at least in the short term. Hence, the big question underlying the current wave of liberalization is whether these reform tendencies are politically sustainable. The next general election in 2010 will give part of the answer.