The surprising ingredients of Swedish success – free markets and social cohesion

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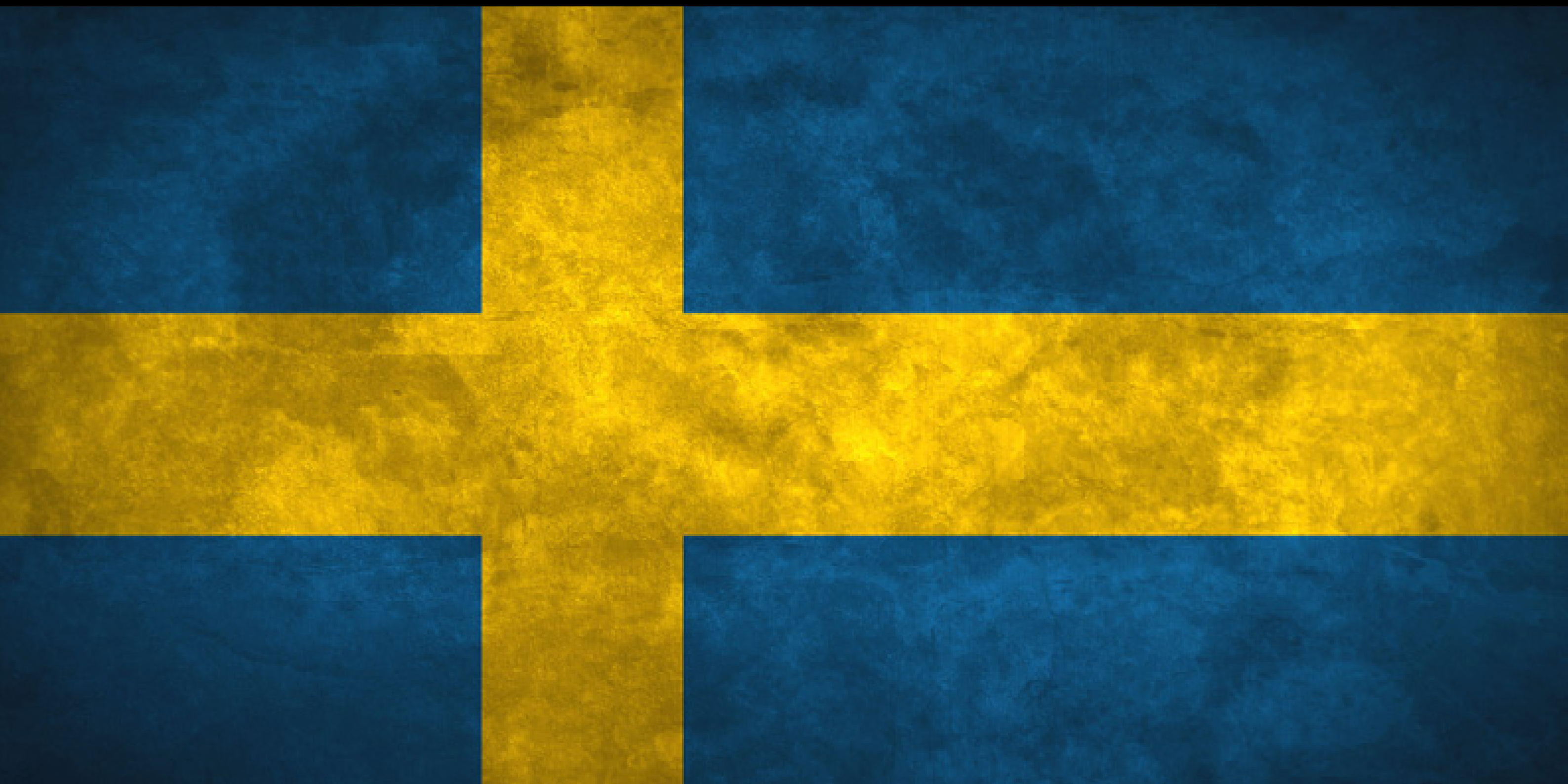

by

Nima Sanandaji

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The Institute of Economic Affairs, 2 Lord North Street, London, SW1P 3LB; Tel 020 7799 8900; email iea@iea.org.uk

About the author

Nima Sanandaji is a Swedish author with a Kurdish Iranian background. He has a Master's Degree from the Chalmers University of Technology in Gothenburg, an Advanced Master's Degree from The Royal Institute of Technology in Stockholm, and has previously conducted research studies at both Chalmers and the University of Cambridge.

Nima has previously published seven books, covering subjects such as entrepreneurship, tax policy, women's career opportunities, integration and innovation within the IT sector. He is also the author of several reports, dealing with various public policy subjects in Sweden, as well as articles in international publications such as *The Wall Street Journal, Human Events and The Guardian.*

Contents

Executive summary

- Sweden did not become wealthy through social democracy, big government and a large welfare state. It developed economically by adopting free-market policies in the late 19th century and early 20th century. It also benefited from positive cultural norms, including a strong work ethic and high levels of trust.

- As late as 1950, Swedish tax revenues were still only around 21 per cent of GDP. The policy shift towards a big state and higher taxes occurred mainly during the next thirty years, as taxes increased by almost one per cent of GDP annually

- The rapid growth of the state in the late 1960s and 1970s led to a large decline in Sweden's relative economic performance. In 1975, Sweden was the 4th richest industrialised country in terms of GDP per head. By 1993, it had fallen to 14th.

- Big government had a devastating impact on entrepreneurship. After 1970, the establishment of new firms dropped significantly. Among the 100 firms with the highest revenues in Sweden in 2004, only two were entrepreneurial Swedish firms founded after 1970, compared with 21 founded before 1913.

- High levels of equality and favourable social outcomes were evident before the creation of an extensive welfare state. Moreover, generous welfare policies have created numerous social problems, including high levels of dependency among certain groups.

- Descendants of Swedes who migrated to the USA in the 19th century are characterised by favourable social outcomes, such as a low poverty rate and high employment, despite the less extensive welfare state in the USA. The average income of Americans with Swedish ancestry is over 50 per cent higher than Swedes in their native country.

- Third World immigrants have been particularly badly affected by a combination of high welfare benefits and restrictive labour market regulations. In 2004, when the Swedish economy was performing strongly, the employment rate among immigrants from non-Western nations in Sweden was only 48 per cent.

- Since the economic crisis of the early 1990s, Swedish governments have rolled back the state and introduced market reforms in sectors such as education, health and pensions. Economic freedom has increased in Sweden while it has declined in the UK and USA. Sweden's relative economic performance has improved accordingly.

Introduction

Sweden is often regarded as a nation whose policies should be emulated by others. Not only is it characterised by high living standards, but also by other attractive features such as high life expectancy, low crime, a high degree of social cohesion and an even income distribution. The same holds for the other Scandinavian countries.

If one disregards the importance of thinking carefully about causality, the argument for adopting a Swedish-style economic policy in other nations seems obvious. Sweden has a large welfare state and is successful. This is often seen as a proof that a ‘third way’ policy between socialism and capitalism works well, and that other nations can reach the same favourable social outcomes by simply expanding the size of government.

If one studies Swedish history and society in-depth however it quickly becomes evident that this simplistic analysis is flawed. The Swedish experience might as well be used to argue for the benefits of free-market oriented policies, and as a warning of the economic and social problems that can arise when government involvement in society becomes too large.

To understand the Swedish experience one must keep in mind that the large welfare state is not the only thing that sets Sweden, and other Scandinavian nations apart from the rest of the world. These countries also have homogenous populations with non-governmental social institutions that are uniquely adapted to the modern world. High levels of trust, strong work ethics, civic participation, individual responsibility and family values are long-standing features of Scandinavian society that pre-date the welfare state.

These deeper social institutions explain why Sweden could so quickly grow from an impoverished nation to a wealthy one through industrialisation and the adoption of the market economy in the late 19th century. It also explains why a large welfare system could be implemented in the mid 20th century, as the combination of strong norms and rapid growth made it possible to levy high taxes and offer generous benefits with less risk of abuse and adverse incentive effects.

In the long run, however, even the well-functioning societies in Scandinavia have been adversely impacted by welfare dependency and high levels of taxation. The ‘third way’ policy has not persisted - it can be viewed as a short-lived and failed experiment.

Throughout most of its modern history Sweden has had a favourable business environment. The period characterised by the most extensive welfare state policies, where Sweden deviated strongly from the western norm, around 1970-1995, is an exception. That period was associated with a stagnant economy.

It is true that Sweden maintains a high standard of living, despite high taxes. But it is wrong to see this as proof that high taxes do not affect the economy. Indeed, studies show that high taxes have significantly hindered economic development in Sweden. While an affluent country, Sweden could have been even more affluent with lower tax rates.

The welfare systems in Sweden and other Scandinavian countries do indeed provide benefits. At the same time, many of the favourable social outcomes in Scandinavian societies were evident before the creation of extensive welfare states. It is also important to realise that the generous welfare policies have not only combatted societal ills, but have also created new social problems. The combination of high taxes, generous government benefits and a rigid labour market has led to dependency amongst a large sub-section of the population and has limited the ability of Swedish society to integrate migrants into the labour market.

In recent years the Swedish economy has grown strongly again, following a return to freer markets. Sweden has conducted market-friendly reforms in many areas, such as openness to trade, personal retirement accounts and private production of welfare services. Taxes have been dramatically reduced. A significant move towards greater levels of economic freedom is also evident in other Scandinavian nations.

A key lesson from the success of Swedish society is that ‘culture’ matters. It is interesting that Scandinavian nations, with their historically strong social norms, are often used as evidence of the success of welfare state policies. However, southern European countries, often with similarly large welfare states, have less favourable outcomes.[1]

We should also not be surprised by the fact that descendants of Swedes who migrated to the USA in the 19th century are characterised by favourable social outcomes, such as a low poverty rate and high employment, despite the less extensive welfare state in the USA. This indicates that deeper social factors such as norms and non-governmental social institutions have played, and continue to play, an important role in Swedish society.

Societies can prosper for many different reasons. In this paper it is argued that the success of Swedish society hinges both on its unique norms and non-governmental institutions, as well as on the free-market policies to which the country is returning.

[1] This is further explored in Sanandaji (2012).

A culture of success

In the beginning of the 20th century, German sociologist Max Weber observed that protestant countries in northern Europe tended to have a higher living standard, more high-quality academic institutions and overall stronger social cohesion than Catholic and Orthodox countries in southern Europe. Weber believed that the cause of the social success of protestant nations was to be found in a stronger ‘protestant work ethic’ (see Nelson, 2010).

Economists seldom focus on the importance of norms and values for economic development. This is partly because cultural factors are inherently difficult to quantify. However, one cannot fully understand the development of the northern European nations without factoring in the unique cultural environment that has developed in the Scandinavian countries, as well as in culturally similar nations such as Germany and the Netherlands. These pre-date the modern welfare state.

Swedish scholar Assar Lindbeck has noted that the Scandinavian countries were for a long time characterised by environments that promoted strong work ethics. It was simply difficult to survive as an agriculturalist without working exceptionally hard in the hostile Scandinavian environment. Out of necessity the population adopted social norms with a great emphasis on individual responsibility and hard work (Lindbeck, 1995; 2003). This is in line with the ideas put forth by Greek philosopher Aristotle, who as early as the 4th century BC observed that people in cold countries had to work harder than those in warmer countries in order to survive (quoted by McColl, 2005).

Although norms, values and other aspects of social capital are inherently difficult to measure, they are nonetheless extremely important for creating well-functioning societies. A good illustration is how levels of trust vary between different societies. The more we trust strangers, the safer we feel. High levels of trust (and trustworthiness) also affect economic performance, by making economic transactions more reliable and by reducing transactions costs.

Anecdotally, many Scandinavians who work with foreigners hear from their business associates that Scandinavian people are generally trustworthy. The high level of trust benefits individual Scandinavians and Scandinavian economies as a whole. Researchers have shown that this view of Scandinavians as being trustworthy has merit. People from Sweden, Denmark, Finland and Norway stand out as the most trusting in the world (Delhy and Newton, 2005; Berggren, Elinder and Jordahl, 2008). In these societies, famous for strong social cohesion and strong work ethics, it often pays to trust strangers.

But are these strong Scandinavian norms a new phenomenon, perhaps arising as a consequence of the Scandinavian welfare systems, or are they underlying cultural traits that have existed for a long time? There is strong support for the latter view. Indeed, as discussed later in this paper there is also support for the notion that the welfare system, instead of strengthening norms gradually over time, has eroded social capital.

Interestingly, US citizens of Scandinavian origin also exhibit similar social norms to Scandinavians who have not emigrated. The migration waves from Scandinavia to the USA mainly occurred during the late 19th century and the early 20th century, before the adoption of welfare state policies in Scandinavia. Therefore, if such social capital accumulated in Scandinavian societies as a consequence of welfare policies, it should be absent amongst Americans with a Scandinavian background. A recent study has examined levels of trust amongst different groups in the USA. It is shown that levels of trust vary significantly between various groups, and in accordance with Weber's observations almost a hundred years ago, is strongest amongst those of northern European descent (Uslander, 2008).

Amongst various groups in the USA, the level of trust seems to be strongly related to the level of trust in their respective home countries. Given that many Americans originating from other countries have lived in the USA for many generations, this observation strongly supports the hypothesis that norms are both persistent over time and coupled to cultural origins. If norms had instead been a product of rapid individual adaptation to the current policies of a nation one would have expected similar levels of trust amongst Americans regardless of their country of origin (ibid.). In fact, individuals of Scandinavian origin have the highest levels of trust in the USA. Indeed, they actually have slightly higher levels of trust than citizens of Scandinavian countries (ibid.).

Trustworthiness is a cultural trait that varies significantly amongst different countries, and tends to be strongest amongst the more developed nations in the world (Delhy and Newton, 2005; Berggren, Elinder and Jordahl, 2008). One can view trust as a form of social contract. Individuals in a society would, as a whole, benefit from having perfect levels of trust. If we could fully trust strangers we would be able to easily co-operate with each other, focusing time and energy on productive activities without the fear of being fooled. The cost of writing and enforcing contracts would be much lower, for example.[2]

However, although society as a whole benefits from perfect trust, each individual might benefit from breaking the norm and deceiving others. Indeed, the more trust there is in a society in general, the more each individual might benefit from breaking the norms and behaving in an untrustworthy fashion. General trust therefore can be likened to a form of social contract, which is difficult to maintain, but which strongly promotes societal success. In some cases, the use of clubs and business associations – with the threat of expulsion for those who behave in an underhand manner – might be effective in nurturing these norms. In societies where high levels of trust arise historically, these values can not only benefit current generations, but can also be passed down from parents to children to benefit also future generations.

It has been noted that accepting oral agreements as legally binding is a centuries-old Scandinavian legal tradition, which strengthens the notion that trustworthiness and honesty have been part of Scandinavian culture for many generations (Lookofsky, 2008).

Indeed, as the Swedish researcher Andreas Bergh and his Danish colleague Christian Bjørnskov recently have written, 'special cultural and historical traits of Scandinavia seem to have affected

[2] The motto of the London Stock Exchange was 'my word is my bond'. This level of trust amongst participants contributed hugely to the success of the exchange.

economic, social and political behaviour and continues to set these countries on a somewhat different behavioural path from that of most other countries' (Bergh and Bjørnskov, 2011). The two authors put forth the argument that the cold Scandinavian climate might have led to a situation where it was very important to be able to trust strangers in order to survive: an idea in line with Aristotle's previously mentioned observation (ibid.).

It is difficult to say if the uniquely strong norms in Scandinavian nations, favouring hard work, trustworthiness and honesty, arose as an adaptation to a harsh climate; because of the homogenous natures of the populations in these nations; because of the Protestant religious teachings; or because of some other factor. It is however clear that strong norms and social institutions give the Scandinavian nations a significant advantage over other societies. This culture of success is likely to have paved the way for the phenomenal wealth creation that occurred in Sweden when an industrialised market economy developed in a previously poor agrarian society.

Free market success story

A popular notion is that Sweden has managed to defy standard economical logic, by managing to grow rich in spite of high taxes and state involvement in the economy. Former Swedish Social Democratic Prime Minster Göran Persson has compared Sweden's economy with a bumblebee: 'With its overly heavy body and little wings, supposedly it should not be able to fly - but it does' (quoted by Thakur et al., 2003). In reality, however, Sweden's economic development is anything but mysterious. The nation's prosperity developed during a period, which was characterised by free-market policies, low or moderate taxes and limited state involvement in the economy.

The Swedish economic experience is rarely mentioned as an example of the power of free markets. Yet few other nations demonstrate as clearly the phenomenal economic growth that comes from adopting free-market economic policies. Sweden was a poor nation before the 1870s, as indicated by massive emigration to the USA around that time. As a capitalist system evolved out of the agrarian society, the country grew richer.

Property rights, free markets and the rule of law, in combination with large numbers of well-educated engineers and entrepreneurs, created an environment in which Sweden enjoyed an unprecedented period of sustained and rapid economic development. In the hundred years following the market liberalisation of the late 19th century and the onset of industrialisation, Sweden experienced phenomenal economic development (Maddison, 1982). Famous Swedish companies such as IKEA, Volvo, Tetra Pak, Ericsson and Alfa Laval were all founded during this period, and were aided by business-friendly economic reforms and low taxes.

Another popular notion is that Sweden´s phenomenal growth rate is closely tied to a period dominated by Social Democratic party rule and high taxes. In fact, between 1870 and 1936, the start of the social democratic era, Sweden had the highest growth rate in the industrialised world. Between 1936 and 2008, however, the growth rate was only ranked 18th out of 28 industrialised nations (Maddison, 2010).

Indeed, at the beginning of the social democratic era, policies were rather pragmatic. As late as 1950, Swedish tax revenues were still only around 21 per cent of GDP. The policy shift towards a big state and higher taxes occurred mainly during the next thirty years, as taxes increased by almost one per cent of GDP annually (Ekonomifakta, n.d.). During the period around 1968 the Swedish Social Democrats radicalised and moved sharply towards the left. It is during this period that the 'third-way' approach dominated as governments aimed to establish a form of economic model between a free-market model and a planned economy. This period was not successful economically.

The failure of 'third-way' policies

Sweden was a wealthy and entrepreneurial nation in the mid-twentieth century. From the late 1960s, policies steered sharply to the left. The overall tax burden rose and this new system discriminated heavily against individuals who owned businesses.

The Swedish economist Magnus Henrekson has shown that the effective marginal tax rate (marginal tax plus the effect of inflation) that was levied on profits earned by Swedish businesses could reach more than 100 per cent. For example, in 1980 a private person who owned a business could theoretically pay an effective marginal tax of 137 per cent (Henrekson, 2007).[3] However, if the business was financed by debt, the tax rate dropped to 58 per cent, since the effect of inflation was reversed, and the business could make deductions from the high taxes. The situation was very different for government owners such as public pension funds, which did not pay taxes, but could make deductions. A public pension fund that invested borrowed money faced an effective marginal tax rate that was minus 83 per cent (see Table 1).

Table 1: Effective marginal capital taxes (including the effect of inflation) in Sweden in 1980

Owner	Debt financed	New share issues	Retention of profits
Households (private owners)	58	137	52
Tax exempt owners (such as public pension funds)	-83	-12	11
Insurance companies	-55	38	29

Source: Henrekson (2007). Calculations based on a return on capital of 10 percent.

Thus, whilst a private, individual owner who invested his own money actually lost money by making additional profit, in effect, the system almost doubled the profits of firms owned by government pension funds. Henrekson drew the conclusion that the tax policies 'developed according to the vision of a market economy without individual capitalists and entrepreneurs' (ibid.).

The sharp left turn in Swedish economic policy did indeed affect entrepreneurship. Axelsson, for example, has shown that the period between the end of the 19th century and the beginning of World War I was a golden age for the founding of successful entrepreneurial firms. In 2004, 38 of the 100 businesses with the highest revenues in Sweden were started as privately-owned businesses in

[3] Calculations based on a real profit of 10 percent.

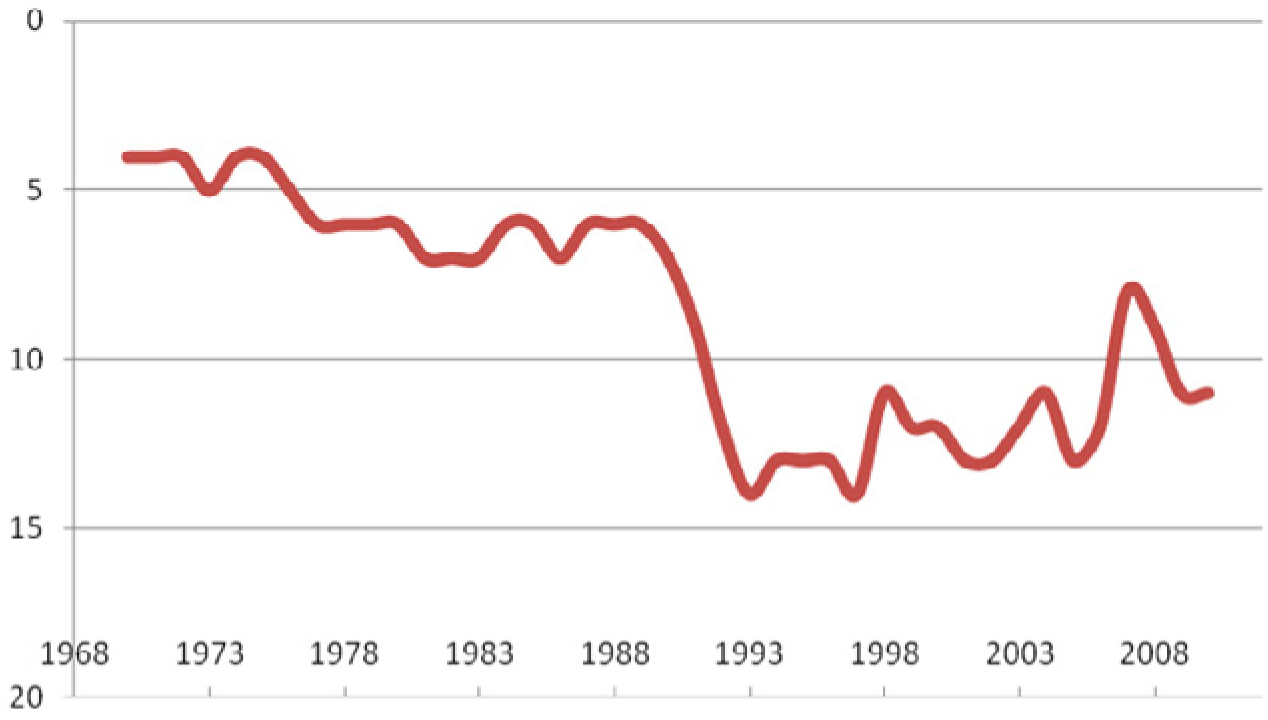
Sweden. 21 of these firms - a clear majority - were founded before 1913, while 15 were founded between 1914 and 1970 (Axelsson, 2006).

After 1970, the establishment of new firms dropped significantly. Among the 100 firms with the highest revenues in 2004, only two were entrepreneurial firms founded after 1970. If the 100 largest firms are instead ranked according to how many people they employ, none of the largest firms were started as privately-owned businesses in Sweden and founded after 1970 (ibid.).

How can this dramatic drop in entrepreneurship be explained? Why is Sweden so heavily dependent on firms that, in some instances, were formed more than one hundred years ago? It is not that firms take so long to grow large, as this pattern is not seen in other western countries. An important factor is the change in economic policy before 1970. Third way approaches are often upheld as the normal state of Swedish policies. However, the use of third way policies predominated over a relatively short period and this was a period of stagnating growth (Lindbeck, 1997; Bergh, 2011).

As recently as 1975, Sweden was ranked as the 4th richest nation in the world. However, rising taxes and an increase in government involvement in the economy led to a slower growth rate. Sweden had dropped to around the 14th place by the mid-1990s (Ekonomifakta, n. d.). Figure 1 shows Sweden's ranking amongst the world's richest nations. Wealth is measured as GDP per capita adjusted for purchasing power and Sweden is ranked in comparison with other OECD nations.[4] It can clearly be seen that the shift in economic policy that occurred in the late 1960s and the 1970s significantly reduced Sweden's economic performance compared with other rich countries.

Figure 1: Sweden's ranking amongst OECD countries



Source: Ekonomifakt

[4] It should be noted that the OECD had 24 member states in 1993, but expanded through the addition of Mexico in 1994, the Czech Republic in 1995, Hungary, South Korea and Poland in 1996, Slovakia in 2000 and Slovenia, Chile, Israel and Estonia in 2010. However, the new arrivals typically have lower purchasing power adjusted GDP per capita levels than the old member states. Thus enlargement does not explain Sweden's drop. Indeed Sweden achieved a low ranking as the 14th richest nation in 1993, before the expansion of the OECD.

The growth rate was particularly low in the period from 1970 to 1995, when the development and influence of the welfare state was at its strongest. Swedish growth rates have improved between 1995 and the present, in part because of recovery from the mid-1990s crisis, and arguably in part due to reduced taxes and extensive pro-market reforms. Pro-market reforms have made it possible for Sweden, to some extent, to regain some of the previous drop in the ‘league table’ of OECD countries (ibid.).

Crowding out the private sector

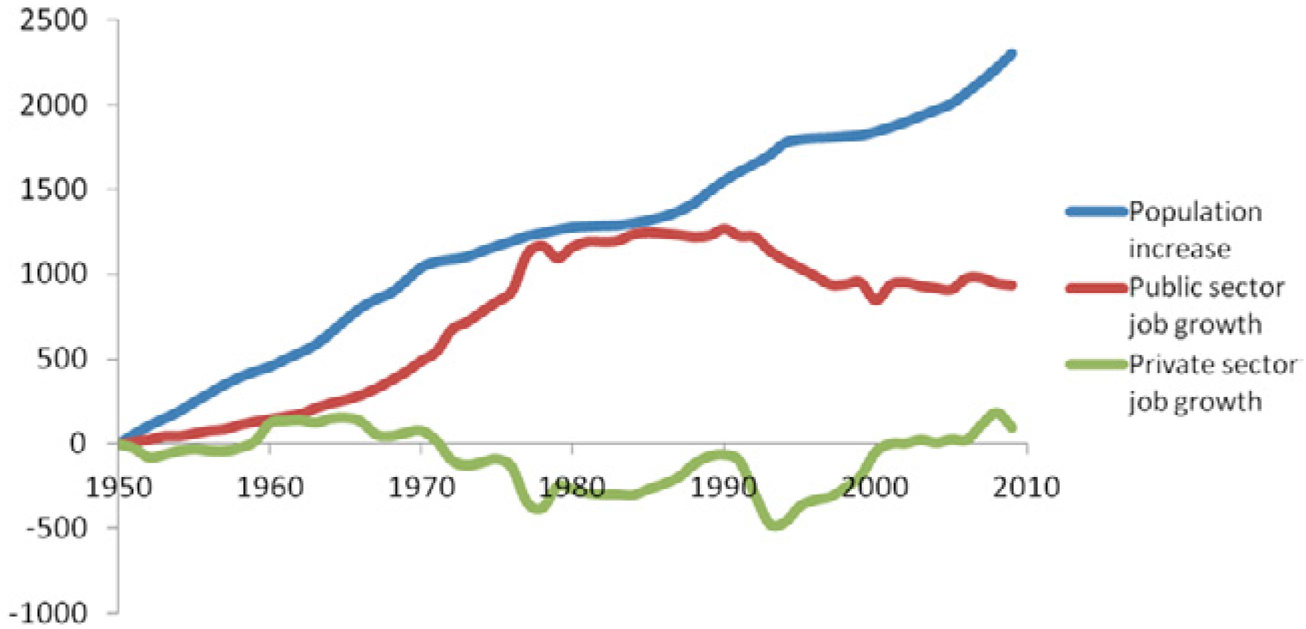
The policy of ‘capitalism without capitalists’ did not only end the golden entrepreneurial age in Sweden and limit economic growth, but also crowded out private sector job creation.

Increasing the size of government is often, at least in the short term, a popular policy. The reason is that new opportunities are created for those who work directly or indirectly with new government activities. The costs of expanding government, in terms of, for example, higher taxes tend to manifest themselves in the long term.

Blanchard and Perotti (2002) show that, since World War II, increases in government spending are associated with a strong negative effect on investment. Similarly, Cohen et al. (2011) show that fiscal spending shocks appear to ‘significantly dampen corporate sector investment and employment activity’. The authors note that the crowding out effect ‘suggests new considerations in assessing the impact of government spending on private sector economic activity.’

The transition towards an extensive welfare state that occurred in Sweden led, as discussed previously, to an economic cost in terms of reduced entrepreneurship, as taxes and regulation hindered the development of private businesses. It also led to a significant crowding out of private employment. Between 1950 and 2005, the Swedish population grew from seven to nine million, but net job creation in the private sector was zero. Jobs in the public sector expanded rapidly until the end of the 1970s. As it became difficult to further expand the already large public sector, job creation simply stopped (Bjuggren and Johansson, 2009).

Figure 2: Increase in population, public sector jobs and private sector jobs (thousands)



Source: Ekonomifakta

Figure 2 illustrates this development, with data up to 2009. Given this lamentable record, it is perhaps not surprising that Swedish policies have become dominated by a discussion on reducing the exclusion from the job market of around one million Swedes of working age who are either in visible or hidden unemployment.

Job creation during the 'free market' and 'third way' periods

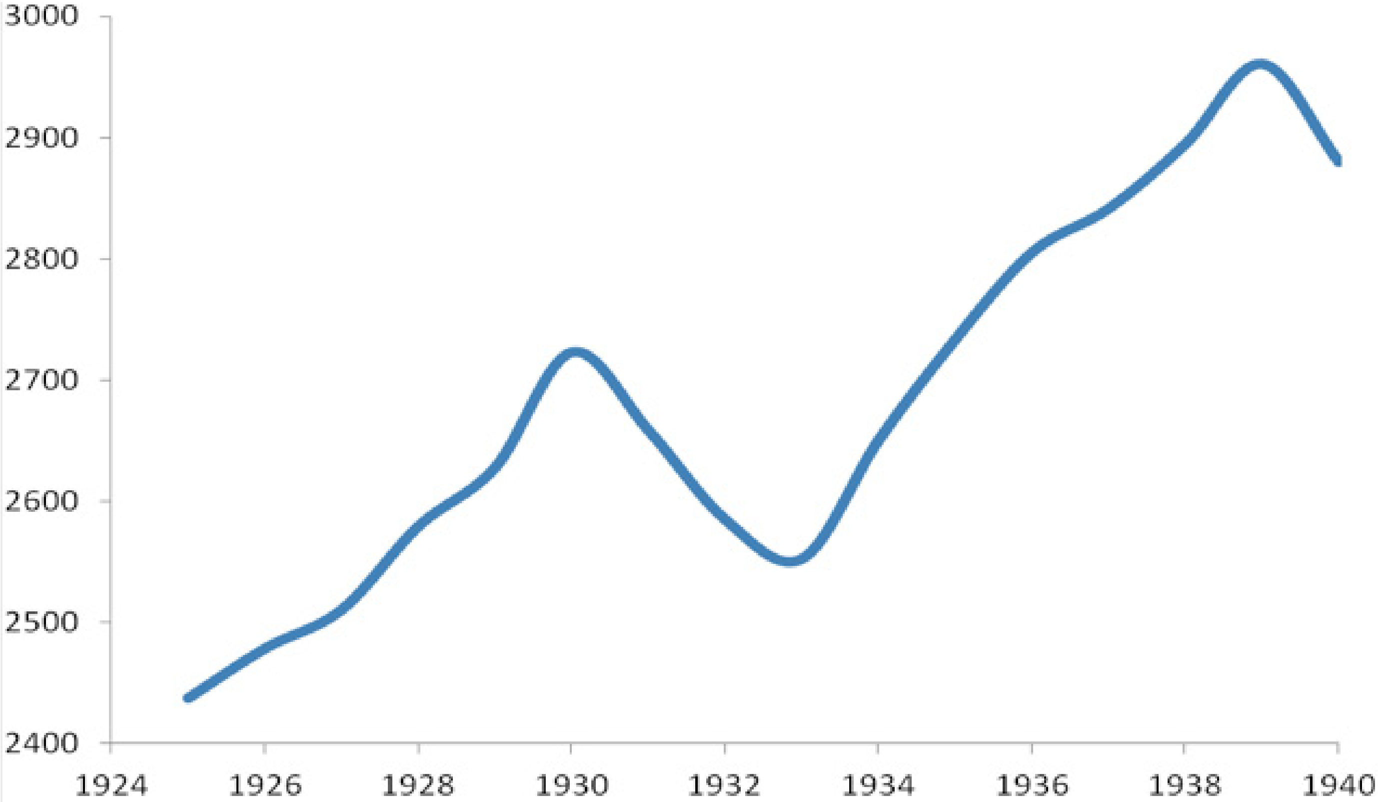
The Swedish economy has been struck by two major economic crises during the 20th century, one during the first half of the century – when Swedish policies were characterised by low taxes and free markets – and another in the second half of the century – when policies were instead characterised by high taxes and a large public sector.

The first crisis was the Great Depression. As a trade-dependent nation, Sweden was not only hurt by the global economic depression, but also by the trade barriers other nations erected in a misguided effort to protect their economies from the downturn. From 1930 to 1933, the number of job opportunities available in Sweden decreased by 170,000 – about six per cent of all jobs (Krantz, 1997).

The crisis could have been severe, especially since it occurred at the same time as many young Swedes were entering the labour force. But the Great Depression was short-lived in Sweden. Job creation occurred rapidly in the dynamic economy. As shown in Figure 3, by 1935 more Swedes were working than before the crisis (ibid.). The reason is that new, innovative businesses were created that replaced many of the jobs that were lost.

The economic downturn led to a structural transition from farming to industry. During the crisis years, Nohab Flight engines, today known as Volvo Aero, was born. Shortly after the crisis, Securitas and SAAB were founded. A new method for making paper mass was invented, leading to the creation of Sunds Defibrator, today known as Metso Paper – a leading developer of paper industry equipment throughout the world. The successful food company Dafgårds was also founded in the 1930s. Even today, close to a century later, Sweden still relies heavily on many businesses started during or shortly after the Great Depression (see, for example, Johnson, 2006).

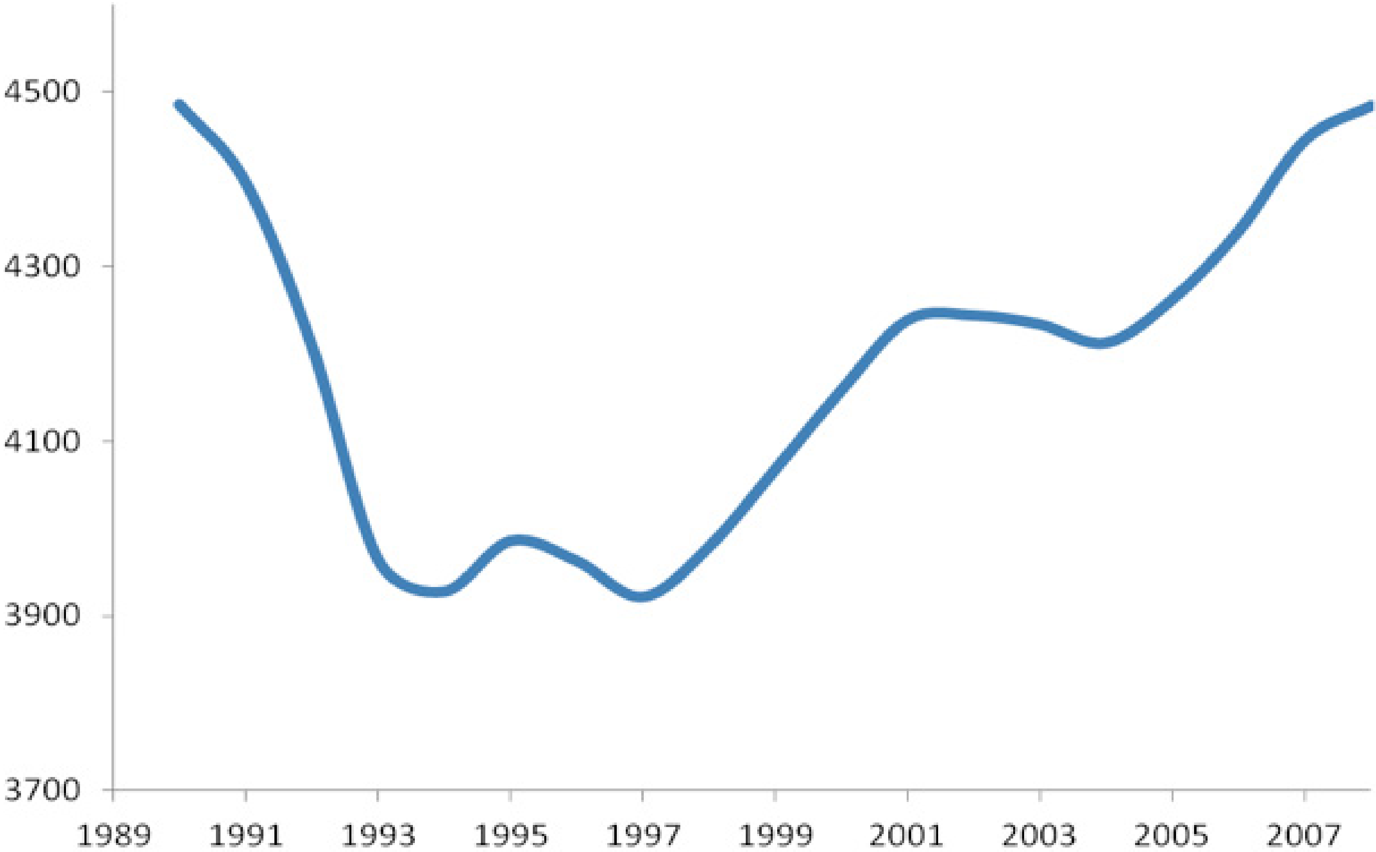
Figure 3: Employment in Sweden before and after the Great Depression (000s)



Source: Krantz (1997)

The beginning of the 1990s saw a new crisis hit the Swedish economy. At a time when unemployment was falling in many other countries, it rose rapidly in Sweden. Employment fell by 12 per cent between 1990 and 1993 (SCB, 2009). Soon afterwards, Sweden followed the global trend of strong economic growth. But rates of employment rose only very slowly. In fact, as shown in Figure 4, it took until 2008 to reach the level attained before the early 1990s – ironically, the same year that a new recession hit Sweden and the world (ibid.).

Figure 4: Employment in Sweden before and after the 1990s crisis (000s)



Source: SCB (Statistics Sweden) (2009).

Clearly, the ability of the Swedish economy to generate new jobs was considerably better after the Great Depression than after the 1990s crisis, although the economic environment following the latter crisis was in many ways better. This is a clear indication that the policy shift towards high taxes, a large public sector and a rigid labour market was unsuccessful.

Of course, the decision to move towards a large public sector is not only based on considerations relating to economic growth, entrepreneurship and job growth, but also on how social outcomes will be influenced.

Social outcomes and the welfare state

Sweden developed state welfare provision during the first half of the 20th century, but the welfare institutions were financed by relatively low taxes. As noted previously, tax revenues were still only around 21 per cent of GDP in 1950 (Ekonomifakta, n. d.). Interestingly enough, the impressive social outcomes of Swedish society were evident already during this period. For example, in 1950, long before the high-tax welfare state, Swedes lived 2.6 years longer than Americans. Today the difference is 2.7 years (SCB database; US Department of Health and Human Services, 2009). It is also interesting that the relatively even income distribution in Sweden pre-dates the expansion of the welfare state.

A comparison of historical rates of income inequality in Sweden, the USA, Canada, France and Netherlands shows interesting results. Already by 1920, well before the existence of a welfare state, Sweden had amongst the lowest levels of inequality within this group of countries. Roine and Waldenström (2008) note the following regarding the evolution of top income shares in Sweden during the period 1903-2004:

> 'We find that, starting from levels of inequality approximately equal to those in other Western countries at the time, the income share of the Swedish top decile drops sharply over the first eighty years of the twentieth century. Most of the decrease takes place before the expansion of the welfare state and by 1950 Swedish top income shares were already lower than in other countries.'

Thus, inequality in Sweden mainly fell before the rise of the high-tax welfare state, during the free-market period characterised by low taxes. The Swedish economist Andreas Bergh has reached similar conclusions. Bergh (2011) concludes: 'From being one of the poorest countries in Europe, the 100-year period from 1870 to 1970 turned Sweden into the fourth richest country in the world. Remarkably … in more or less the same period Sweden also turned into a country with one of the world's most compressed income distributions.'

Bergh finds that inequality started to increase again from around 1980 onwards. The trend is interesting, since many of the hallmarks of the Swedish welfare state, such as extensive labour market regulations, high taxes and extensive government transfers, became predominant in Sweden in the 1970s.

For most of the period between 1910 and 1970 the top marginal tax in Sweden was lower than in the USA, whilst taxes as a proportion of GDP were similar in the two countries until around 1960. Clearly the even distribution of incomes in Sweden began to arise well before the welfare state, and the trend towards lower inequality reversed to one of higher inequality around 1980, during the peak of the third way policies. Bergh concludes: 'When it comes to equality, the most important conclusion is that most of the decrease in income inequality in Sweden occurred before the expansion of the welfare state. A number of seemingly unrelated reforms, such as land reforms, school reforms and the occurrence of unions and centralised wage bargaining, are likely explanations' (ibid.). One cannot say that the Swedish welfare system has not contributed to the unusually even income distribution in the country, but clearly it is far from the sole factor explaining the development.

Of course, when looking at a factor such as income distribution, the fact that Sweden (as well as other Scandinavian welfare states) has an unusually homogenous population also plays a quite significant role. Part of the increase in income inequality since around 1980 relates to the increased inflow of immigrants to Sweden. As discussed below, policies of high taxes, generous benefits and a regulated labour market have hindered integration of migrants into the labour market. This, of course, contributes to rising inequality. But even labour market integration had functioned well one could expect inequality to rise somewhat as Sweden moved from a very homogenous nation, to the current situation where the nation still is relatively homogenous when compared with many other countries, but considerably less so than a few generations ago.

One might expect Sweden, which has a uniquely even distribution of incomes, to also have an even distribution of wealth. Remarkably, however, the opposite is true. Sweden has an unusually uneven wealth distribution, with recorded values lower than for the USA (Skattebetalarnas Förening, 2009). The reason for this uneven distribution of wealth is that many Swedish households depend on government safety nets and therefore do not save. Around 30 per cent of Swedish households have negative, or zero, assets. Another 20 per cent have asset levels that correspond to around one month's salary for a normal household (ibid.). The Swedish welfare state has promoted a society characterised by vast differences in private wealth, with many families lacking a private safety net.

It is likely that this situation will change, as dissatisfaction with government safety nets prompt many families to begin saving. One could also argue that the adaptation to welfare systems by reducing family savings represents an erosion of positive societal norms. After all, one of the key lessons traditionally passed down from parents to children is to always build up a private safety net.

Success of Swedes in the US system[5]

One important reason why Sweden performs well according to many social metrics has its roots in history and sociology: Sweden and other Scandinavian nations have, for hundreds of years, benefited from sound institutions, potentially a strong Lutheran work ethic and high levels of trust, civic participation, and cooperation. These cultural phenomena do not disappear when Swedes cross the Atlantic and emigrate to the USA. The 4.4 million or so Americans with Swedish origins are considerably richer than average Americans, as are other immigrant groups from Scandinavia.

If Americans with Swedish ancestry were to form their own country, their per capita GDP would be $56,900, more than $10,000 above the income of the average American. This is also far above Swedish GDP per capita, at $36,600. Swedes living in the USA are thus approximately 53 per cent more wealthy than Swedes (excluding immigrants) in their native country (OECD, 2009; US Census database).

It should be noted that those Swedes who migrated to the USA, predominately in the nineteenth century, were anything but the elite. Rather, it was often those escaping poverty and famine. The success of this group illustrates both the pervasiveness of norms and low-level social institutions, which to some degree have been hindered in the pursuit to create 'social good' by the economic policies implemented in Sweden. According to data from the Bureau of Labor Statistics, Americans with Swedish ancestry do not have significantly higher aptitude test-scores than other European immigrant groups, and score no higher than Swedes in Sweden, which confirms that immigrant Swedes were not a 'selected' elite group.[6]

A Scandinavian economist once said to Milton Friedman, 'In Scandinavia, we have no poverty'. Milton Friedman replied, 'That's interesting, because in America, among Scandinavians, we have no poverty, either' (quoted by Kotkin, 2009). Indeed, the poverty rate for Americans with Swedish ancestry is only 6.7 per cent: half the US average (US Census). Economists Notten and Neubourg (2007) calculated that the poverty rate in Sweden using the American poverty threshold was an identical 6.7 percent, though it should be noted that the Swedish figure includes poor immigrants.

This points us towards the conclusion that what makes Sweden uniquely successful is not the welfare state, as is commonly assumed. Rather than being the cause of Sweden's social strengths, the high-tax welfare state might instead have been made possible by the hard-won Swedish stock of social capital. It was well before the welfare state, when hard work paid off, that a culture with a strong work ethic and strong trust and social cohesion developed. As discussed above, the modern system has eroded some of these norms. The Swedish welfare state must contribute to the reduction in inequality by providing substantial social security safety nets. Yet it is clearly not the only reason

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[5] Some of the facts and arguments in this section appeared in a column David Brooks published in the New York Times on 3 May 2010. It should be noted that the author of this report co-authored an article with the same statistics and arguments in The New Geography on the day prior to the publication of Mr. Brooks' article. The articles are included in the footnotes. *See New Geography* (2010) and *New York Times* (2010).

[6] Bureau of Labor Statistics, NLSY-97 study of approximately 9000 youths of age 12-16.

– or the main reason - for the low poverty rate and long life expectancy in the nation. Indeed, as discussed in the coming sections, the welfare policies have also contributed to social problems in some respects.

Welfare dependency creates social poverty and deteriorating work norms

As discussed previously, the expansion of the Swedish welfare state has coincided with a crowding out of private sector job creation. The result has been that a significant share of the Swedish population has become dependent on government transfers rather than work. In the year 1960 each Swedish adult who worked in the private sector had to support an additional 0.38 persons who mainly received their incomes from the public sector. With the rise of the welfare state, and demographic changes, the share of public sector employees, retirees and unemployed individuals has risen significantly. In 2009 each private sector employee had to support 1.44 individuals mainly receiving their income from the public sector – almost four times the number in 1960 (Eklund and Henrekson, 2010).

Since the beginning of the 1990s, approximately one fifth of the Swedish population of working age has been supported by unemployment benefits, sick leave benefits and early retirement benefits. Among others, Jan Edling, former economist at the labour union LO, which has close ties to the Social Democratic party, has discussed this high hidden unemployment, and its connection to the over-use of welfare systems (Edling, 2010; Swedish Enterprise Institute, 2006; Herin, Jakobsson and Rydeman, 2006).

It is not difficult to understand how the combination of rigid labour regulations, high taxes and generous government benefits has led to a situation where many are excluded from the labour market. It is, however, important to realise that this is not just an economic but a social, problem.

The point of a generous welfare state is to aid individuals, but the Swedish system has also created huge levels of dependency. One illustration is that many young Swedes have been classified as early retired, in order to be hidden from unemployment statistics. A policy change has led to the use of a different term from that of ‘early retired’, but in effect the policy is continuing even today (Sanandaji, 2011).

Between 2004 and 2008 close to 3 per cent of young Swedes between 20-39 years were supported by early retirement. Large differences can be observed between different parts of Sweden, with significantly more early retirement amongst youths in regions with high unemployment. This reinforces the notion that early retirement, to a large degree, is a way of hiding unemployment, rather than a system to help individuals who cannot be expected to support themselves due to disability (ibid.).

Policymakers in Sweden are aware of the fact that early retirement is a system for hiding true unemployment. The benefit levels given to early retired youth are amongst the least generous in the Swedish transfer systems. But another consequence is that those youths who are born with, or acquire, disabilities that prevent them from working, will also receive amongst the lowest levels of public transfers. As a greater proportion of Swedish society has become dependent on state handouts, those who really need help do not get it (ibid.).

Of course, young people who are retired out of the work force are a small group of those who are excluded from the Swedish labour market. There are other groups for which dependency on government handouts, rather than work, can translate into relatively low incomes and a form of social poverty that arises as norms related to work and individual responsibility deteriorate.

This is in line with the notion put forth by Nobel laureate Robert Fogel, who has explained that the poverty that exists in modern societies to a large degree can be explained by an uneven distribution of ‘spiritual resources’ such as self-esteem, a sense of discipline and a sense of community (Fogel, 1999). Undeniably, the Swedish welfare system combats economic poverty, as well as social poverty, in many ways: for example through income redistribution to low-income families, mandatory and tax financed schooling for all children, and transfers to those who do not work. However, as the move towards high taxes, regulated labour markets and generous benefit systems has led to welfare dependency, one can also argue that the welfare state is creating poverty, especially in the spiritual, or social, form.

For a long time, the religious, cultural, and economic systems in Sweden fostered strong norms related to work and responsibility. These norms were important for the success of the Swedish free-market system. Social Democratic politicians also saw them, coupled with the fact that Sweden was a uniquely homogeneous society, as the optimal starting point for an expanding welfare state.

Since the norms relating to work and responsibility were so strong, Swedish citizens did not usually try to avoid taxes or misuse generous public support systems. Also, the ‘one-solution-fits-all’ systems of the welfare state are typically less disruptive in a strongly homogeneous social environment, since most of the population has similar norms, preferences, and income levels.[7]

Thus, these strong social norms opened the way for a huge expansion of government. But as Swedes became accustomed to a system of high taxes and generous government benefits, the norms gradually declined. In the World Value Survey of 1981-84, almost 82 per cent of Swedes agreed with the statement ‘claiming government benefits to which you are not entitled is never justifiable.’ Sweden was still a nation with very strong morals related to public benefits. As the population adjusted its norms to the higher tax regime, the number who held this view dropped steadily in further surveys. In the survey of 1999-2004, only 55 per cent of Swedish respondents believed that it was never right to claim benefits to which they were not entitled (Heinemann, 2007). Further detail is given in Table 2.

[7] For example, it is difficult to introduce a system of social security that is generous to the middle class if the income level varies significantly between the middle class and those with the lowest incomes. If the benefit level is high enough to be generous to middle class individuals, it might be above what those with low incomes can earn, due to their lower productivity. In a homogeneous society, with less initial spread of income to begin with, a system can be designed that, to a large degree, feels generous to the middle class, whilst not reducing the incentives of low income earners as much as it would in a heterogeneous society.

Table 2 Public benefit-related attitudes in Sweden

1981-84	1989-1993	1994-1999	1999-2004	2005-2008
81.5	74.5	57.9	55.3	61.0

Percentage of people agreeing with the statement 'claiming government benefits to which you are not entitled is never justifiable'. Source: Heinemann (2007) with the latest World Value Survey data for 2005-2008 added.

A link between welfare payments and cultural transmissions of work ethics has been suggested by Michau (2009). He notes that parents make rational choices regarding 'how much effort to exert to raise their children to work hard', based on their 'expectations [regarding] the policy that will be implemented by the next generation.' Therefore a lag will exist between the introduction of certain policies, or even a public debate regarding future policies, and changes in the work ethic. Building a model with a lag between these two factors, Michau argues that generous unemployment insurance benefits can explain a substantial fraction of the history of unemployment in Europe after World War II (ibid.).

Recently, Swedish policies have shifted to the centre-right, and a long-term social democratic hegemony has turned into a situation where the Social Democrats are in deep crisis. This may be partly because the Swedish electorate wishes to again strengthen the work ethic and responsibility norms that were eroded during the high tax regime. Both government policy and the public debate in Sweden have focused on reducing the over-use of welfare services in recent years. As shown in Table 2, there has been an upward swing in moral views with regard to state benefits.

A number of attitude studies in Sweden conclude that a significant portion of the population have come to believe that it is acceptable to live on sickness benefits without being sick. Modig and Broberg (2002), for example, showed that 41 per cent of Swedish employees believed that it was acceptable for those who were not sick but felt stress at work to claim sickness benefit. Additionally, 44 and 48 per cent respectively believed that it was acceptable to claim sickness benefits if people were dissatisfied with their working environment or had problems in their family (ibid.).

Other studies have pointed to increases in sickness absence due to sporting events. For instance, absence due to sickness increased by almost 7 per cent among men relative to women during the Winter Olympics in 1988, and by 16 per cent during television broadcasts of the World Championship in cross-country skiing in 1987 (Skogman Thoursie, 2004).

During the 2002 football World Cup, the increase of sickness absence among men increased by an astonishing 41 per cent compared with women. The stark difference between the events during the end of the 1980s and the beginning of the 2000s might be seen as an indication of the deterioration of morals over time observed by the World Value Survey (Persson, 2005).

This deterioration of norms supports the theory of Lindbeck (1995) regarding self-destructive welfare state dynamics, in which the welfare system erodes norms relating to work and responsibility. Changes in the work ethic are related to a rising dependence on welfare state institutions. Lindbeck has noted that explicit benefit fraud in Sweden, where, for example, individuals receive unemployment benefits or sick-pay and actually work at the same time in the shadow economy, leads to weakening of norms pertaining to the ‘over-use’ of various benefit systems. Reforms to limit fraud are instrumental in order to maintain the welfare system (Lindbeck, 2008). Indeed, reforms that have created stronger ‘gate-keeping’ functions in welfare services, in order to limit over-use and make benefits less generous, have lately been implemented in the Swedish welfare system.

Although Swedish society has been known for a strong work ethic and social norms, they have not been resistant to high taxes and generous welfare programmes that have diminished the incentive to work and created an incentive to overuse the welfare system. Norms do have a strong persistence, as they are passed down from parents to children, but in the long run they do adapt to changing circumstances. In the same manner that Scandinavians developed a good work ethics and high levels of trust over a long time, they are now beginning to adapt their norms to generous welfare systems.

The dilemma is that, for welfare systems to work, the population should have a strong work ethic and strong morals about claiming benefits, whilst high taxes and generous handouts encourage the opposite. This dilemma might explain the political pressure to reform welfare systems not only in Sweden, but also in other Nordic nations. In Denmark for example, even the Social Democrats have recently demanded that individuals take more responsibility for their own lives in the future welfare model (Jyllands Posten, 2012).

Failing integration policies

During the free-market era in the first half of the 20th century Swedish society was very successful in integrating immigrants. In 1950, the rate of employment for the foreign-born was 20 per cent higher than that for the average citizen (Ekberg and Hammarstedt). However, in 2000, the rate of employment was 30 per cent lower for the foreign-born. In 1968, foreign citizens living in Sweden had an income from work 22 per cent higher than those born in Sweden; in 1999, foreign citizens had incomes that were 45 per cent lower (ibid.).

While racism decreased significantly as time passed, the situation in the labour market of those born abroad worsened dramatically. A government study showed that in 1978, foreign-born residents from outside the Nordic nations had a rate of employment that was only seven per cent lower than that of ethnic Swedes. In 1995, the gap had expanded to 52 per cent (Ekberg, 1997).

Why did this drastic shift occur? One reason is that Sweden shifted from labour immigration to refugee immigration. However, it is important to remember that the nations from which labour immigrants came to Sweden after World War II – such as Greece and Turkey – were relatively impoverished at the time. Also, many of the refugees who have come to Sweden from nations such as Chile, Iran and Iraq are from the educated elite and middle class, seeking a better life abroad.

To give an illustrative example, a privileged group of well-educated citizens fled from Saddam Hussein's Iraq to Sweden at the end of the 1980s and the beginning of the 1990s. Of those Iraqis that stayed in Sweden between 1987 and 1991, they were 2.3 times as likely to have a higher education of more than three years, compared with native Swedes. So, how well did this highly-educated group do in the Swedish labour market? In 1995, only 13 per cent of the women and 23 per cent of the men from the group were employed (Rooth, 1999).

Another Swedish research study has calculated the incomes of immigrants from Iran and Turkey. Between 1993 and 2000, the income from work for the average Iranian immigrant was only 61 per cent of that of a native Swede and that of the average Turkish immigrant 74 per cent (SCB and Arbetslivsinstitutet, 2002). This contrasts with the situation in the USA. According to the US Census for 2000, those born in Iran had an income that was 136 per cent of the average for native-born residents, compared with 114 per cent for those born in Turkey (US Census, 2000). Clearly, similar groups of immigrants had very different opportunities in the USA compared with Sweden.

In 2004, when the Swedish economy was performing strongly, the employment rate among immigrants from non-Western nations in Sweden was only 48 per cent. It should be noted that this definition in Swedish statistics also includes some people that do not hold a regular occupation, such as those participating in publicly-financed labour market programme (Sanandaji, 2009).

Dependence on government welfare was nine times as high for non-Western immigrants compared with those born in Sweden the same year (SCB, 2004). That Sweden has gone from being a nation which successfully integrated the foreign-born into the labour market, to one where many immigrants are trapped in long-term dependency on government handouts, is not only linked to changes in immigration policy, but also to general economic policy. The expansion of the Swedish welfare state since the mid-twentieth century has created a situation where the incentive to work has reduced, whilst the incentive to live off government handouts has increased. At the same time, regulations and labour union domination impede entry into the labour market (Sanandaji, 2009).

There is no doubt that a generous welfare system initially helps many immigrant families, cushioning the transition to a new country. However, as long-term dependency grows, it can easily transform into social poverty. The fact that social problems exist among immigrants to Sweden is not a coincidence. The failure of Swedish integration policies also leads to a situation where many of those who are excluded from the labour market do not partake in wider Swedish society, and hence not only fail to build up social capital, but also face a depreciation of their own skills. In wider society, a lack of integration breeds cultural divides that tend to lead to a decline of society-wide trust. Such is also the case in Norway and Denmark, which, like Sweden, have failed in their integration policies (Finland however has received few immigrants, and has thus not experienced the same obstacles).

The hidden rise in taxation

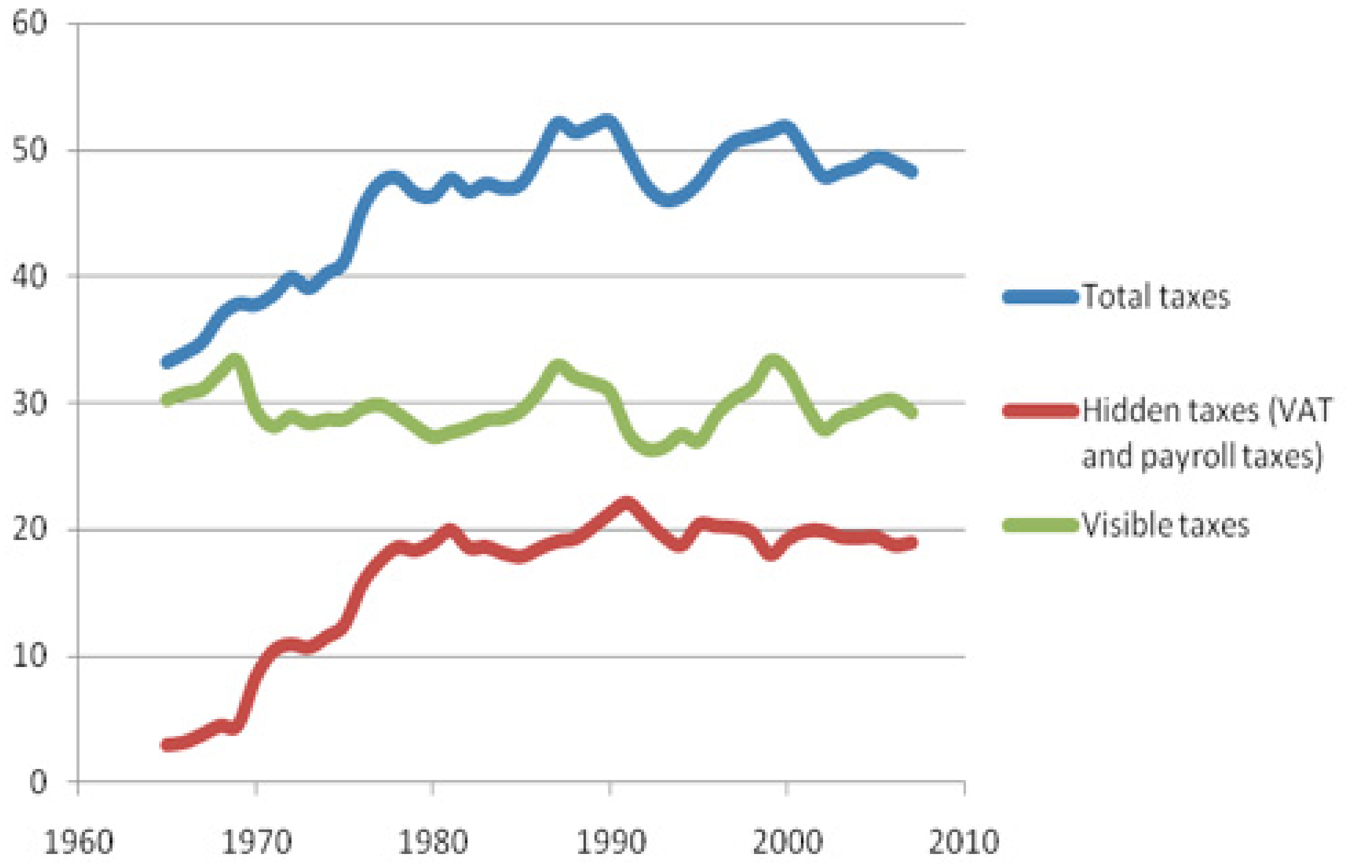
In 1950, Swedish tax revenues were around 21 per cent of GDP. In the next thirty years, taxes increased by almost one per cent of GDP annually (Ekonomifakta, n. d.). How was this huge increase in taxation possible?

One explanation is that many Swedes supported the policies of the leading Social Democratic party, which held power in government over much of the twentieth century. Another possible explanation is that the rise in taxation was effectively hidden from the public.

As the Italian economist Amilcare Puviani predicted in 1903 (cited in Baker, 1983), and Nobel laureate James Buchanan discussed further, it is easier for politicians to raise hidden, indirect taxes rather than visible taxes (Buchanan, 1960). Changes in Swedish taxation strongly support this hypothesis. In Figure 5, it is shown that the entire rise in taxes since 1965 can be attributed to the introduction and gradual increase of an indirect sales tax (VAT) and the slow but steady rise of the indirect employer's payroll contributions.

Without this rise in hidden taxation, taxes in Sweden would have remained at around 30 per cent of GDP. Swedish politicians have not increased visible taxes that would have proven unpopular with voters. As will be discussed later, Swedish taxes have however been lowered significantly during the past few years. One explanation for why they have not decreased even more might be that the total tax burden remains obscured to a significant degree. For example, in a survey conducted in 2003, the Swedish public was asked to estimate the total amount of taxes they paid. Almost half of the respondents estimated that the total taxes they paid amounted to around 30-35 per cent of their income. At the time of the survey, the real total tax rate levied on an average income earner (including consumption taxes) was 63 per cent (Sanandaji and Wallace, 2011).

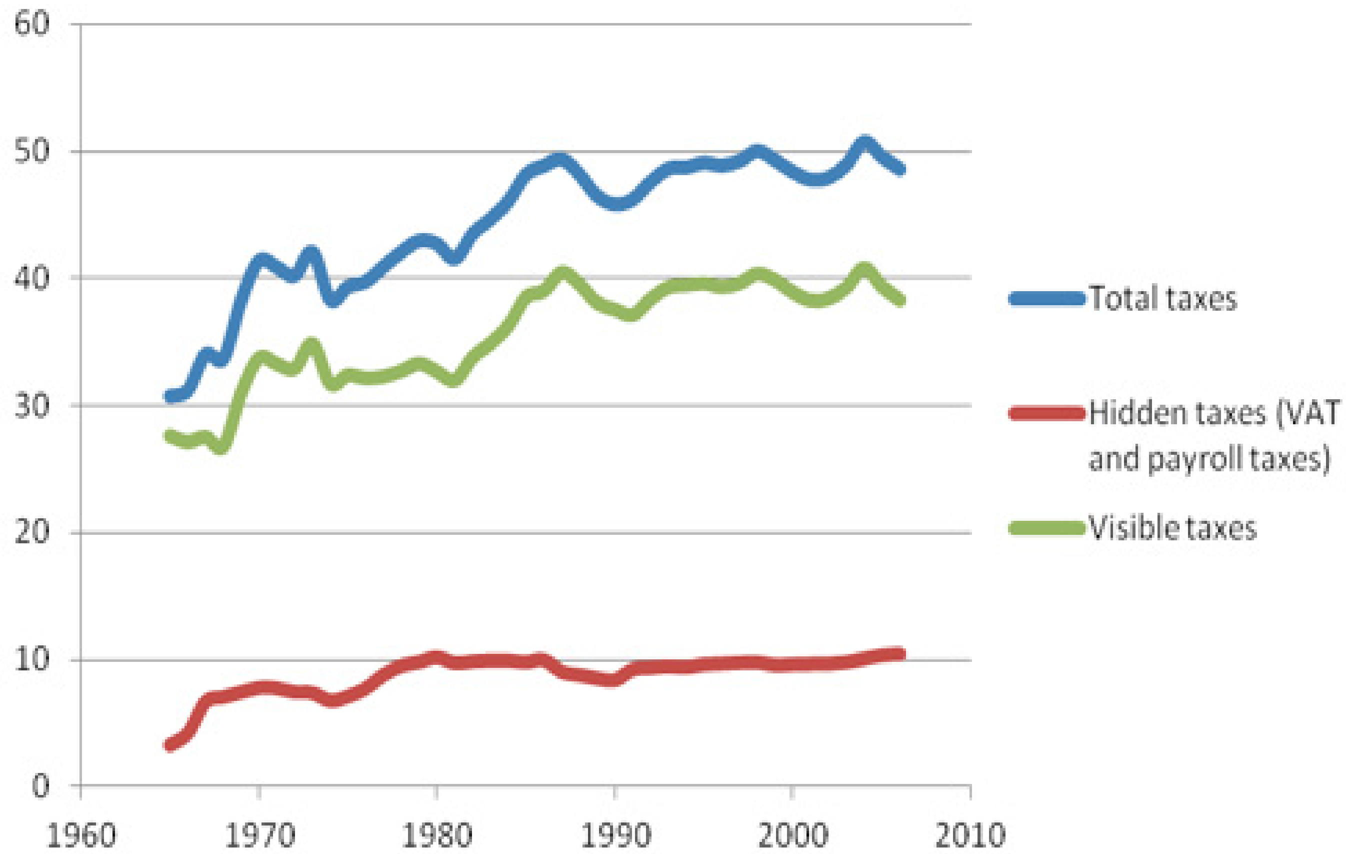
Figure 5: Hidden and visible taxes in Sweden (percentage of GDP)



Source: OECD.

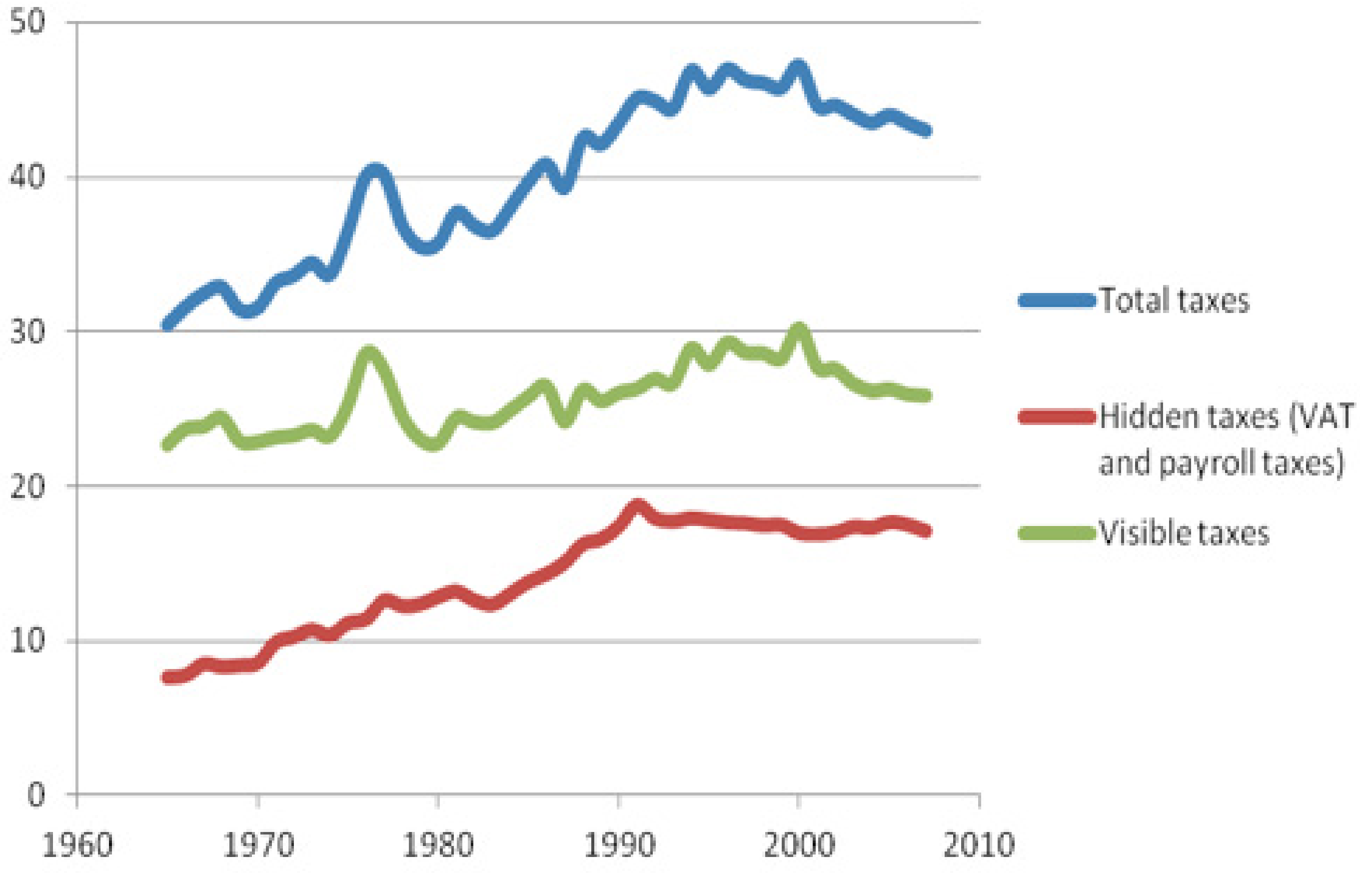
Other more recent studies lend support to the idea that many Swedes are unaware of how much hidden tax is levied on their incomes (see, for example, Larsson, 2009). Figures 6-8 illustrate the development of visible and hidden taxes in Denmark, Finland and Norway, as a percentage of GDP. Denmark is unique in having significantly raised visible taxes. In Finland and Norway the move towards high taxation has, as with Sweden, occurred by significant increases of hidden taxes whilst visible taxes have remained below 30 per cent of GDP. In all four Nordic nations, except oil-rich Norway, levels of taxation have begun to fall during recent years.

Figure 6: Hidden and visible taxes in Denmark (percentage of GDP)



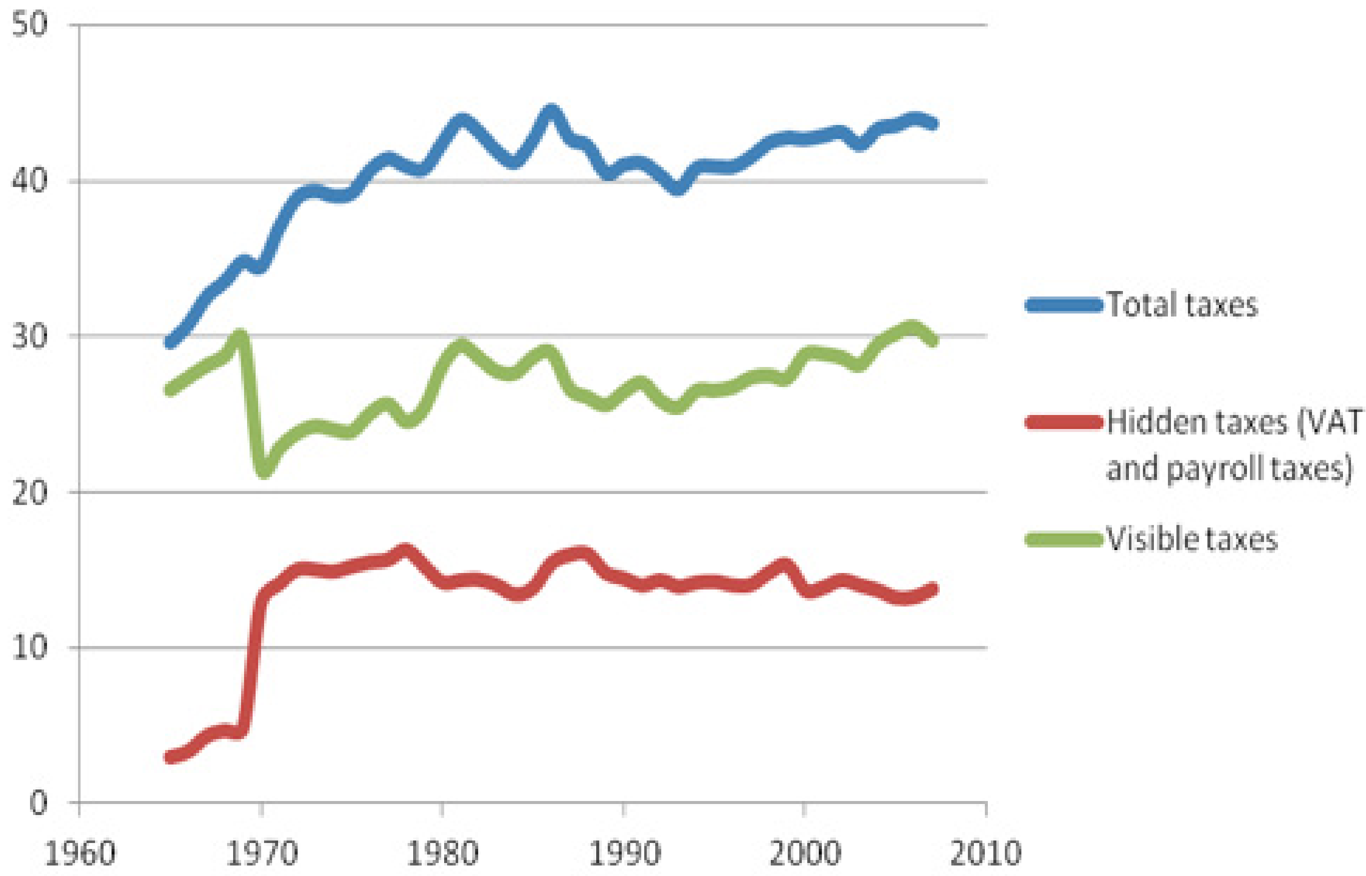
Source: OECD.

Figure 7: Hidden and visible taxes in Finland (percentage of GDP)



Source: OECD.

Figure 8: Hidden and visible taxes in Norway (percentage of GDP)



Source: OECD.

Although many taxes remain hidden in Sweden, they do affect the economy. By hindering entrepreneurship and private sector job growth, the expansion of taxes and public spending leads to slower economic growth in Sweden than would otherwise have been the case. The perception that Sweden has a unique economic policy, which is not affected by high taxes, does not find support in tax research. A number of studies have shown that the high levels of taxation are indeed damaging to the economy. A new study published by the European Central Bank, for example, finds that Sweden is on the tip of the Laffer curve when it comes to average taxes on incomes. This means that increasing taxes on labour would have such a damaging effect on the economy that tax revenues would not increase. However, this also indicates that existing taxes choke off so much economic activity that the additional revenue from a rise in rates is very small. Tax rates in Denmark and Finland are also shown to be close to this extreme case (Trabandt and Uhlig, 2010).

With regard to capital taxation, Sweden is on the wrong side of the Laffer curve. This means that capital taxes are so damaging that reducing them by only one Swedish krona would stimulate the economy so that more than one krona in additional taxation could be levied (at a lower tax rate). The same is true for Denmark and Finland (ibid.).

Several other studies from Sweden support the idea that the nation is at, or close to, the tip of the Laffer curve (for example, Holmlund and Söderström, 2007; Pirttilä and Selin, 2011. For instance, one study showed that for each additional Swedish krona levied and spent by the government, the effective loss in the private sector can be up to three additional kronor (Hansson, 2009).

Although it is a popular belief that high taxes have not impaired economic development in Sweden and other Scandinavian nations, they have been shown by research publications to be so damaging that they even prevent the increase in public revenue that is the intention of the high level of taxes. The affluent Scandinavian nations would be even more affluent with a lower tax burden.

Free-market Sweden?

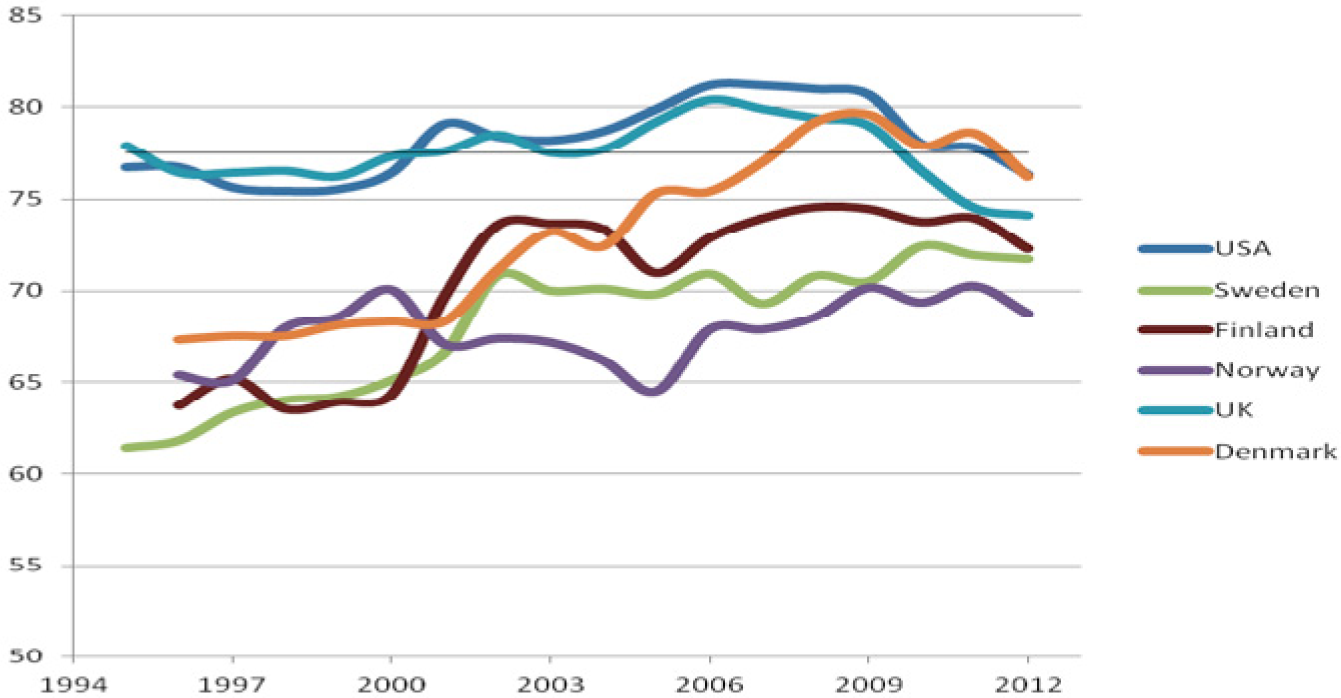
When Sweden is used as an example in policy debates, not only the successes but also the limitations are often exaggerated. It is important to realise that Sweden is not a socialist nation at heart. Taxes are high and the labour market rigid, but policymakers have sought to compensate for the lack of economic freedom in these spheres with economic liberalisations in other parts of the economy.

Five dimensions of economic freedom are included in the Economic Freedom of the World Index developed by the Fraser Institute: size of government; legal structure and security of property rights; access to sound money; freedom to exchange with foreigners; and regulation of credit, labour and business. Bergh and Henrekson (2010) found that, between 1970 and 2004, Sweden and other Scandinavian nations scored poorly on the first dimension: size of government. However, on the other four dimensions, the Scandinavian nations had much higher scores than other groups of industrialised nations.

Since the beginning of the 1990s, Sweden has implemented a number of free-market reforms which, in some cases, even surpass the US system. School vouchers were successfully introduced, creating competition within the framework of public financing (see, for example, Freeman, Swedenborg and Topel, 2010). Similar systems are increasingly being implemented in other public programmes as well, such as health and elderly care. Another example is the partial privatisation of the pension system, giving citizens some control over their mandated retirement savings (ibid.).

In Figure 9, the overall scores from the Heritage Foundation's Index of Economic Freedom are shown for Sweden, Denmark, Finland and Norway, as well as for the USA and the UK for comparison. In the mid 1990s, when the first data for the index were gathered, the four Nordic nations had considerably lower levels of economic freedom than the two Anglo-Saxon nations. In 2012 however, much of the gap had vanished as the Nordic nations had increased their overall level of economic freedom whilst the levels had decreased somewhat in the USA and the UK.

Figure 9: Heritage Foundation Index of Economic Freedom, annual overall score

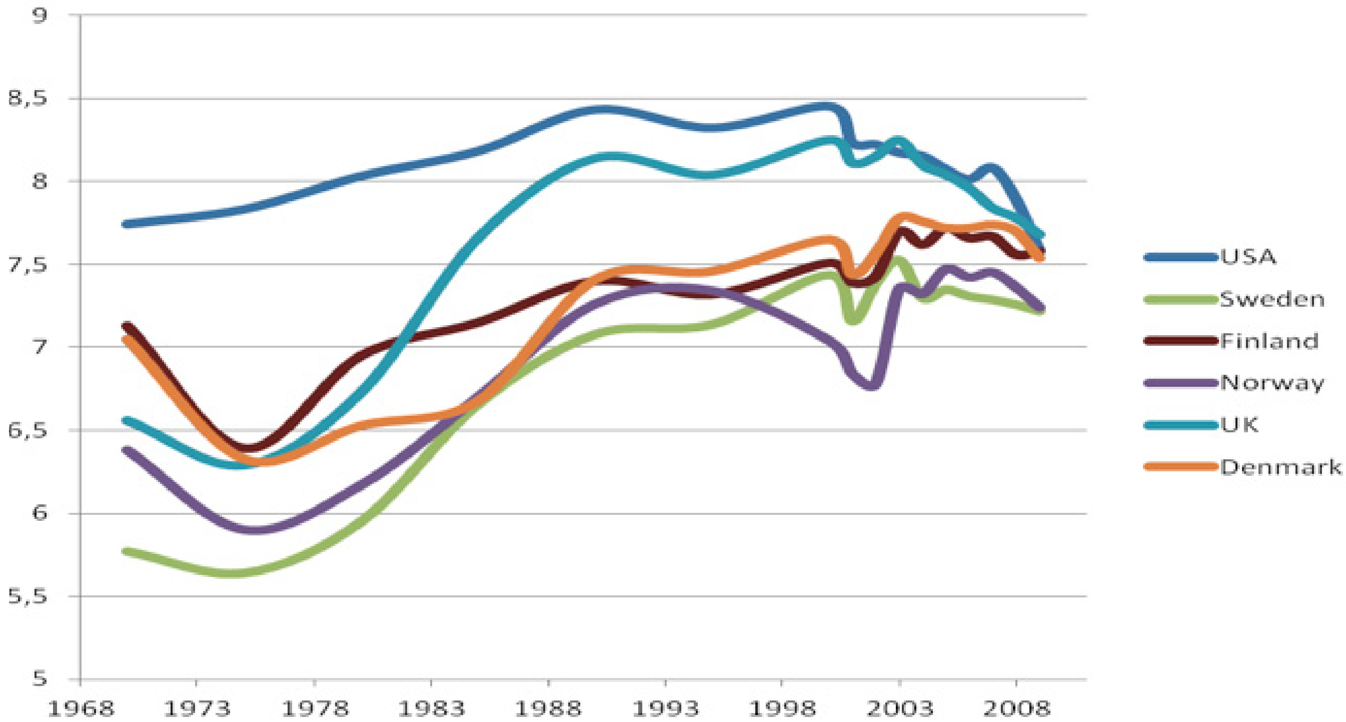


Source: Heritage Foundation Index of Economic Freedom.

Sweden had an unusually low level of economic freedom in the mid 1990s, even compared with the other Nordic nations. This supports the notion that the Swedish experiment with a 'third way' policy was more far-reaching than that in other Nordic nations. Denmark had the highest level of economic freedom amongst the Nordic countries in the mid 1990s, and ranks today at the same level as the USA, even slightly above the UK. Norway has increased its level of economic freedom the least amongst the Nordic nations. The country has retained many of the social democratic policies, something that has been made possible by the country's great oil wealth. In 1999 the Swedish social democratic minister of business Björn Rosengren famously claimed that Norway was really 'the last Soviet state' (Aftonbladet, 1999).

In Figure 10, the country scores are shown for the Economic Freedom of the World Index published by the Fraser Institute for the same countries. This index, which stretches back to 1970, captures both the decrease in economic freedom in the Nordic countries at the beginning of the 1970s and the subsequent increase that has followed. The general trend of convergence between the Nordic nations and the two Anglo-Saxon nations, shown in the Heritage Foundation Index, can also be observed in the Fraser Institute index. Also in the latter index, Sweden stands out amongst the Nordic nations with the lowest levels of economic freedom until the end of the 1990s. A difference between the two indices is that Norway scores as having a relatively more free economy in the Fraser index.

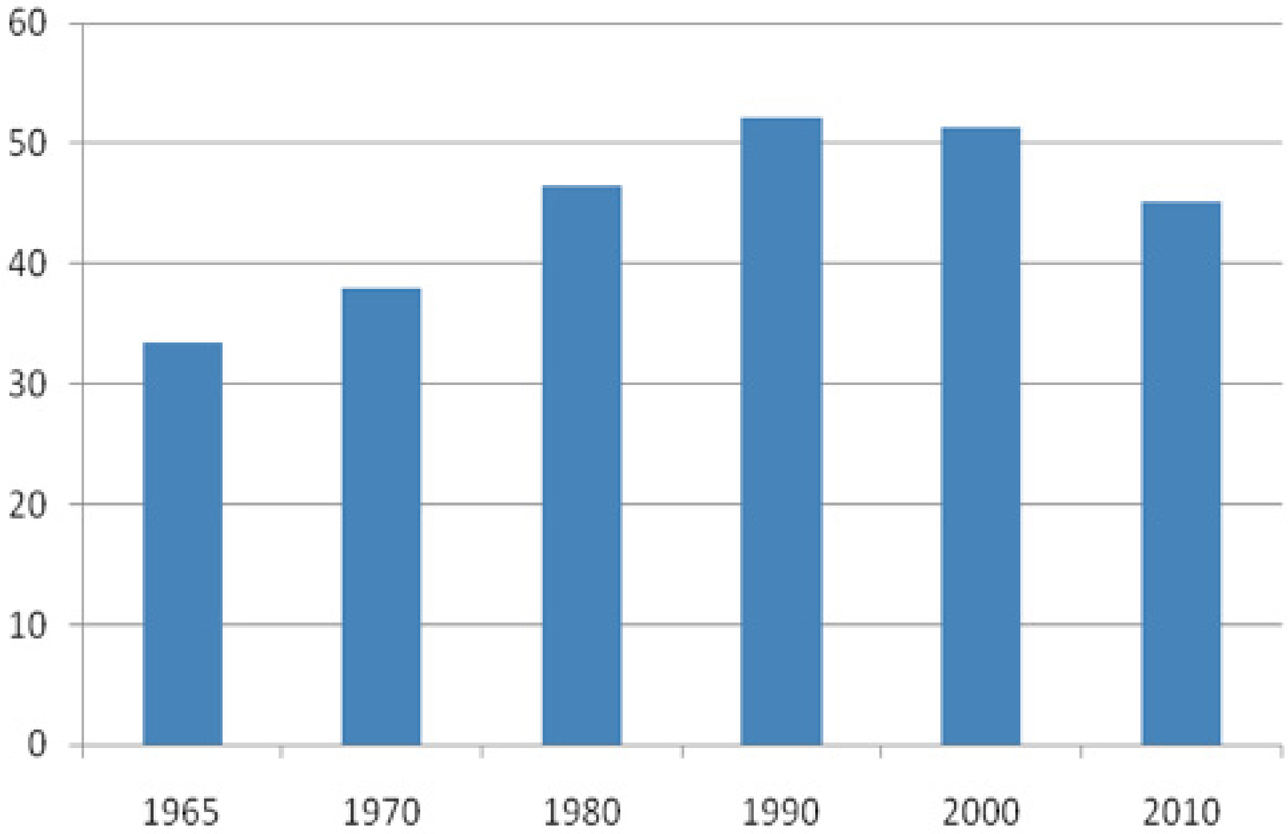
Figure 10: Fraser Institute Economic Freedom of the World Index



Annual chain-linked summary score index. Source: Fraser Institute (2011).

The Swedish centre-right government that took office in 2006, and was re-elected in 2010, has even implemented rather large tax reductions. The tax burden has, as illustrated in Figure 11, begun to fall. Coupled with reduced benefit levels for unemployment and sick-leave, the tax cuts have created stronger incentives for work. This has allowed Sweden to reduce total unemployment between 2006 and 2011. Economists at the Swedish parliament have found that the total hidden and visible unemployment fell from 26.7 per cent of all adults (16-64 years old) in December 2006 to 24.6 per cent in December 2011 (Expressen, 2012).

Figure 11: Tax revenues as a percentage of GDP



Source: OECD and Swedish Government (2010).

The fact that Sweden was able to achieve reduced unemployment during a period characterised by global economic crisis as well as the influx of a substantial number of refugees illustrates the success of the ‘workfare’ policies which have been a focus of the new government.

Sweden´s impressive economic performance during the crisis has prompted the Washington Post to refer to the nation as the ‘rock star of the recovery’, praising amongst other policies its fiscal conservatism (Washington Post, 2011). The Financial Times has also praised Sweden´s new economic policy, by ranking Finance minister Anders Borg as the Finance Minister of the year (Financial Times, 2011). Pragmatic reforms towards greater levels of economic freedom, and greater incentives for work rather than welfare, have indeed been a more successful path for Sweden than the failed experiment with ‘third way’ socialism that the nation is still famous for abroad.

Conclusion

Scandinavian societies have developed a unique culture with a strong work ethic and strong ethical attitudes regarding the claiming of welfare benefits. There are also high levels of trust and social cohesion. This social capital, which was built up before the advent of the modern welfare state, has played an important role in the success of Scandinavian countries.

For many decades, this pre-existing culture, allowed countries such as Sweden to have extensive welfare systems without the social difficulties, rise in worklessness and other effects that many would have predicted. Scandinavian countries have also reaped the rewards of relatively free market policies in some areas of economic life to reach impressive levels of wealth creation.

To characterise the Swedish model either as a social democratic utopia or a failed socialist experiment is a mistake. Sweden is a successful country in terms of having a low poverty rate and long life expectancy. However, these factors have much to do with non-government facets of Swedish society that pre-existed the welfare state.

As Milton Friedman has previously noted, the millions of US residents of Swedish descent also display low rates of poverty. They combine this with a living standard that is significantly better compared with Swedes living in Sweden. The transformation of Sweden from an impoverished agrarian society to a modern industrialised nation is a rarely mentioned, but quite significant, example of the role of free markets in lifting a country out of poverty and into prosperity. Low levels of inequality and low levels of government spending characterised this period of economic transformation. The golden age of Swedish entrepreneurship - when one successful firm after another was founded in this small country and gained international renown – occurred at a time when taxes and the scope of government were quite limited.

Sweden shifted to radical social democratic policies in the 1960s and 1970s, with a gradual reversal beginning in the mid 1980s. The social democratic period was not successful, as it led to much lower entrepreneurship, the crowding out of private sector job production and an erosion of previously strong work and benefit norms. The move towards high taxes, relatively generous government benefits and a regulated labour market preceded a situation in which Swedish society has had difficulty integrating even highly-educated immigrants, and where a fifth of the population of working age are supported by various forms of government welfare payments.

It is also important to remember that Sweden, like other Scandinavian nations, has compensated for policies of high taxes and welfare benefits by improving economic liberty in other fields. Some reforms, such as the partial privatisation of the mandatory pensions system and voucher systems in schools and healthcare surpass reforms in most developed nations. Since these reforms, and the reduction in taxes from the very-high levels of the 1970s to mid 1980s, Swedish relative economic performance has improved.

Swedish society is not necessarily moving away from the idea of a welfare state, but continual reforms are being implemented that increase economic liberty and incentives for work within the scope of the welfare system. Such trends are also visible in Finland and Denmark, with only oil-rich Norway being an exception.

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Institute of Economic Affairs
2 Lord North Street
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SW1P 3LB

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