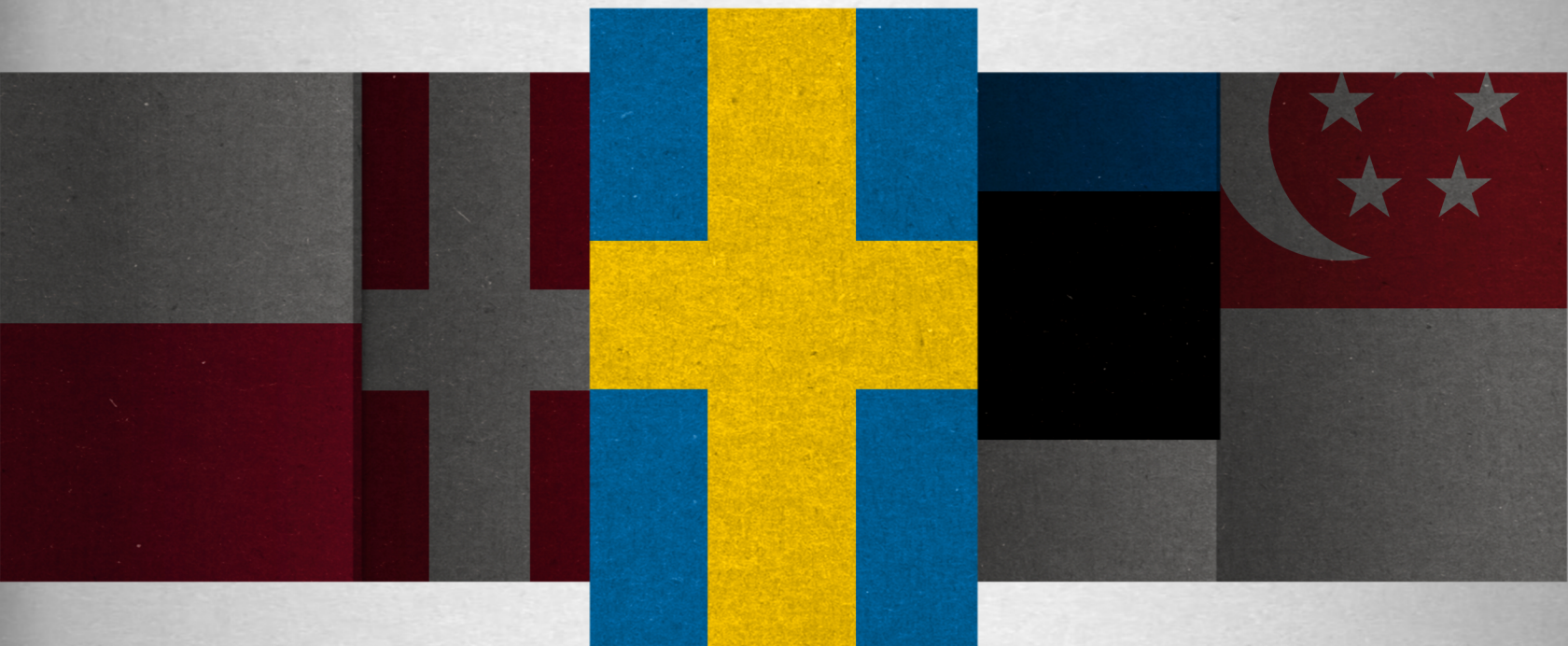


# THE MIRAGE OF SWEDISH SOCIALISM

The Economic History of a Welfare State

Johan Norberg



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The Economic History of a Welfare State

Johan Norberg



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## CONTENTS

Introduction	1
History Part I: From Rags to Riches	3
History Part II: The Rise and Decline of Socialism	21
Part III: The Evolution of Sweden’s Fiscal policy	39
Part IV: The Evolution of Sweden’s Social Policy	53
Conclusion	77
References	81
Publishing information	89
Supporting the Fraser Institute	90
Purpose, funding, and independence	90
About the Fraser Institute	91
Editorial Advisory Board	92

## INTRODUCTION

*“What do you think of socialism?”*

*“I’m a Social Democrat.”*

*“Not a socialist?”*

*“No, if you call yourself a socialist, they confuse you with a lot of crazies.”*

*—Göran Persson, Social Democratic Prime Minister 1996-2006*

Much of what the outside world thinks it knows about the Swedish model is wrong. When American politicians like Senator Bernie Sanders and Representative Alexandra Ocasio-Cortez are asked to name an example of a successful socialist economy, they often point to Sweden.

But Sweden only began to experiment with socialist ideas after it was already one of the world’s most successful societies. Its success was based on a free market model developed after an episode of radical liberalization between 1840 and 1870 and the rapid growth it unleashed. As early as 1950 Sweden was the fourth richest economy in the world, and it was also one of the freest, with public spending below 20 percent of GDP. Government was smaller than in other Western European countries and taxes were slightly lower than in the United States.

Only in the 1970s and 1980s did Sweden expand government dramatically with more spending, taxation, and regulation. It is reasonable to say that during this time Sweden was moving towards socialism. But that was an aberration in Sweden’s history, an aberration that was not associated with success. On the contrary, this was the one period in modern economic history when Sweden lagged behind other industrialized countries.

Incentives for work and entrepreneurship were weakened, and welfare dependency increased. The private sector stopped creating jobs, real wages stagnated, and many of Sweden’s most important businesses, like IKEA and Tetra Pak, fled the country. Sweden ran large budget deficits every year and got stuck in a dangerous spiral of inflation, devaluations, and debts. It ended with a deep financial crisis in the early 1990s that included a brief period when the central bank interest rate rose to 500 percent.

At that time, Sweden’s political parties decided, often in consensus, to return elements of the older capitalist model. They deregulated the economy, reduced taxes, shrank government, and introduced a set of fiscal rules that has reduced public debt substantially. The

pension system was reformed and many government-owned businesses were privatized. Sweden abolished taxes on wealth, gifts, and inheritances.

At the same time, Sweden became a pioneer in privatizing welfare services, making it possible for private providers to compete with public ones on similar terms and funding, and giving citizens the freedom to choose between different providers of elder care, health care, preschool, and education, including for-profit businesses. Around a fifth of all tax-funded welfare services are now provided by the private sector.

Sweden's level of social spending makes it a fairly average western European economy with a more open economy. Its welfare state is still larger than in the United States and other Anglo-Saxon countries, but it mostly distributes resources over an individual's life cycle rather than between groups. Sweden learned in the 1970s that a universal welfare state cannot rely on tax revenue from small groups of high-income households but has to take more in income tax from low- and middle-income groups; it also relies on revenues from a proportional value-added tax. Paradoxically, its tax structure means that Sweden's tax system is now one of the *least* progressive in the OECD.

With the exception of the size of government, the Swedish economy is now more free-market-oriented than the US economy according to Economic Freedom of the World data. After the new reform period in the 1990s and early 2000s, Sweden once again started outperforming other industrialized countries economically, creating new companies and increasing real wages.

## FROM RAGS TO RICHES

On June 4, 1857, Sweden's minister of finance, Johan August Gripenstedt, surprised the other members of parliament with a broad, visionary speech about how Sweden could become a wealthy country.

Through free enterprise and a modern banking system, a national railway system and free trade, Sweden's potential would finally be unleashed, capital and labour would move to their most productive uses, and specialization and innovation would turn the economy into a powerhouse. The 43-year old minister, at that time the government's strong man, told the incredulous crowd that a new, open, and free Sweden would soon abolish poverty and ignorance. Indeed, Sweden's future "has never been more promising than it is now," said Gripenstedt, deeply influenced by the French economist Frédéric Bastiat:

we can with certainty predict a development to which perhaps no other country in Europe can equal. This requires, however, that the resources we have, but which still for the most part lie dormant, unexploited, are duly utilized. (Gripenstedt, 1871: 243)

For his audience, this vision was a bit much. Sweden was one of Western Europe's poorest countries, with a GDP per capita a third lower than Denmark's and less than 40 percent of Britain's. Gripenstedt was met with skepticism and ridicule. His hopeful speech was mocked as "flower paintings." But in the end, it would be he who would have the last laugh.

### Poor but free

Sweden was very poor, but it also had great potential as Gripenstedt had suggested. That potential lay not just in its vast forests and iron ore. It was also present in its people and its peculiar history. The one thing you have to understand about Swedes is that they always heard the rustling of trees, wrote Vilhelm Moberg, the Swedish commoner's great novelist and historian (1970: 61). Sweden did not have many castles or big urban centers. As late as 1820 Stockholm only had around 75,000 inhabitants. No more than 16,000 people lived in the second biggest city, Gothenburg.

Sweden was a country of poor, but free farmers. What sets Sweden apart from almost all other European countries is that it never had a feudal system. Dense woods in a vast, scarcely populated country made it difficult for mounted knights to defeat peasant armies

or guerillas. Sweden's nobility was small and weak and as long as farmers paid their taxes to crown and church, they could control their own land and labour. In most countries, cities symbolize freedom—the place where serfs could escape in a crowd. In Swedish stories and poems, freedom is to be found in the countryside and in the forests.

This meant that the Swedish state did not face much resistance from strong regional elites, powerful aristocrats, or independent cities. Swedish kings could unify the country under national law, one administrative system, and one religion, in a way that was much more difficult on the European continent. The ethnically homogenous farmers were obviously not free in a modern sense. They were subjected to heavy taxation, regulations of business, trade, speech, and family life, and the one true Lutheran religion according to the Augsburg Confession.

Furthermore, individuals were subjected to strictures from family and village. But these were also arenas for cooperation and defense against external powers. By meeting and debating at village and parish meetings, poor farmers became accustomed to the public square, to formulating demands, arguing for their position, and making compromises. The public square was, in a sense, the nursery of modern Swedish democracy. If the village could reach a consensus, it had a strong voice it could use against lords and kings. The main powers in Sweden were the farmers and the government, and the inevitable tensions that arose between the two groups made cooperation possible and necessary. Farmers were continuously represented in the popular assembly, the Riksdag, from the sixteenth century onwards.

The economic historian Mauricio Rojas has argued that in these farming communities we find an explanation for a peculiar Swedish paradox: Proud, self-reliant individualists who are also conflict averse, consensus-oriented, and ready to submit to the collective.

No farmer was anything on his own. The farmers in our country were poor and insignificant as long as they were considered as isolated individuals. But the picture changes radically when we consider them as collective. Then hundreds of thousands of small and insignificant selves are transformed into a powerful we. (Rojas 2004: 23)

Farmers were free as a collective, which meant that anyone who deviated from the group, who did not compromise, could be a threat to everyone's freedom and thus was often ostracized. So Swedes have strong, individual opinions, but work hard to merge them into a consensus opinion, which will make their chances of winning collectively greater:

It is a balancing act between public collectivism and private individualism, between groupthink and defending ones' corner, which is extremely difficult to understand and master for an outsider. (Rojas, 2001)

This tradition of embedding decision-making processes in society makes it possible for that society to make difficult decisions. If most people have been heard throughout the process through their interest groups and representatives, they can more easily buy into the



end compromise, even if it is painful. Unfortunately, that process also makes it incredibly difficult to be a naysayer, to reject compromises, and to point out dangers and mistakes. Therefore, Sweden has a tradition of sticking to the path it has chosen and ignoring problems until they become too big to deny and everybody changes their minds at the same time. Then Swedes move fast in the opposite direction. Far from following the famed “middle way,” Sweden has often been a country of extremes. It liberalized the economy more than other countries did in the mid-1800s, socialized more than others in the mid-1900s, and then reversed course and liberalized again faster than others in the late 20<sup>th</sup> century.

Sweden’s unusual domestic peace and political representation meant that its people did not see its state as an external, occupying force, as was the case in many other European countries. This may explain the remarkably high level of trust that Swedes have in strangers and in government. Their political representation and government authorities are rarely made up of strange outsiders, but of people who look like and talk like them. Some also see the make-up of Swedish society as one reason for the Swedish work ethic. For independent farmers it never made sense to be work-shy to save strength and rob a lord or occupier of income. Swedish farmers mostly worked for themselves, so hard work and self-reliance paid off.

These farmers were remarkably literate. Sweden introduced mandatory elementary education in 1842, but as early as 1800 around 90 percent of Swedes could read. Egil Johansson, the pioneer of Swedish literacy studies, writes: “It must be regarded as an established fact that general reading was achieved without formal school attendance. Swedish home instruction was so successful that those who only received home instruction were, in reality, regarded as able to read in the official statistics” (Johansson, 2009: 55f). An important reason for the high literacy rate was the catechesis imposed by the church since 1686. Every year, the priest made home visits to ensure that everyone had a good, basic, and consistent knowledge of Lutheran teaching. This was just rote learning and did not encourage writing, but as agriculture became commercialized, bookkeeping and correspondence made reading and writing skills lucrative. In the mid-1800s, around 70 percent of military recruits could write. Lars G. Sandberg describes Sweden around 1850 as “the impoverished sophisticate” (Sandberg, 1979).

The great and often tumultuous land reforms of the late eighteenth and early nineteenth century had turned this class of peasants into small capitalists. The old system where every farmer owned several pieces of land split about the village was replaced with a connected piece of land for each farm. This undermined the village community and put an end to collective farming, but it also created strong incentives to invest in new methods and equipment, and productivity increased dramatically.

In many European countries agricultural modernization was led by elites, but in Sweden property-owning farmers took the initiative and profited from it. They introduced new technologies faster than both landed aristocrats and the peasants who rented land from them. The Swedish agricultural revolution was a “bottom-up” process (Wiking-Faria,

2009: 20), and this increasingly wealthy group became the leading supporters of the opening up and liberalization of the Swedish political and economic system that took place in the mid nineteenth century.

### The reform period (1840-1870)

*A period of rapid political and economic liberalization, the establishment of strong property rights, freedom to conduct business, free trade, free financial markets, women's rights.*

Despite the relative freedom of its farmers, Sweden was a very unfree society in the early 1800s. It had a tightly controlled mercantilist economy where most business activities were overseen and regulated by the central government. Guilds had the legal right to control production, employment, and prices. Internal movement was restricted and shops and workshops were banned in the countryside. Just a few privileged banks were allowed, and interest rates were controlled by the government. Women had no right to own or inherit property or do business.

Property rights were weak overall. Farmers could own their land, but they were not allowed to divide it or sell it freely. Relatives and the government always had the right to acquire land before outsiders did. Sweden's most important resources were reserved for domestic use and often government use. Logging was tightly controlled and export of lumber restricted. The export of ore and pig iron was banned. High tariffs, more than 300 import bans, and about 50 export bans had the effect of generally strangling international trade.

Anders Chydenius (1729-1803), a priest from a poor rural region of Finland, then part of Sweden, was the first to propose that the country take a new direction toward political and economic liberalism.<sup>1</sup> His arguments for the rights of rural folk to trade freely was so popular that he was elected a representative to the priest estate in the Swedish parliament in Stockholm in 1765/66. There, he managed to implement an internationally unique statute allowing freedom of the press and abolishing censorship. King Gustaf III wrested control from parliament in 1772 and repealed the statute, but it was restored after 1809.

Chydenius published a series of pamphlets that developed an early radical form of economic liberalism inspired by Enlightenment philosophy. In *The National Gain*, published in 1765, Chydenius explained that a free market is self-regulatory since the profit motive and the price mechanism keep us all in check and stimulate us to help others and produce what they want the most. On this simple observation, Chydenius built an entire worldview that envisioned individual freedom and free markets. It was the invisible hand 11 years before Adam Smith's *The Wealth of Nations*. Step by step ideas like his helped Swedes see that there were other ways of governing themselves (Jonasson and Hyttinen, 2012).

One of Chydenius's disciples was Georg Adlersparre (1760–1835), an officer and enlightenment publicist, who called the belief in personal freedom and property rights “liberal” as early as 1804. Adlersparre was the first to translate Smith's *Wealth of Nations* into Swedish, but he was also the man behind the revolution of 1809, the only violent revolution in modern Swedish history. The king at the time, Gustav IV Adolf, had become increasingly despotic and led the country into a failed war with Russia, France, and Denmark simultaneously. In late 1808, Swedish forces had to surrender the eastern half of the country—Finland—to invading Russians and many feared that Sweden would be completely broken up. Adlersparre took control of the Western army, then issued a proclamation saying that the army had to march to Stockholm and depose the king to save the country. The king was arrested, and a self-described “liberal” faction fought for radical reform in the revolutionary parliament of 1809/10.

The French revolution served as a cautionary tale for Sweden and Parliament ended with a more guarded compromise—a compromise that survived for 165 years. It chipped away at some of the privileges of the monarchy and aristocracy, but mostly it served to create more checks and balances and give parliament a stronger role. Chydenius's anti-censorship law was also resurrected. The scene was set for decades of turbulent debates, where economically empowered farmers teamed up with liberal nobles, civil servants, and a growing bourgeoisie to advocate for more substantial change.

Another central character in the reform period was the entrepreneur and member of parliament Lars Johan Hierta (1801–1872). In 1830 he created *Aftonbladet*, a very successful and influential newspaper that became the most important platform for the liberal opposition. Its radical agitation created space for more moderate reformers to emerge, such as Johan August Gripenstedt, as the establishment began to suspect that some change had to happen to prevent a revolution.

Between roughly 1840 and 1870 Sweden experienced a peaceful liberal revolution. Secure property rights were established, including the freedom to divide, transfer, buy, and sell land. The regulations that had stopped the development of the timber and iron industries were lifted. The guilds were abolished in two steps, the first 1846 and the second 1864, after which anyone, including women, could start a business and compete freely. Sweden got a joint-stock company law with limited liability as early as 1848, which it modernized in 1895. It established a banking system and deregulated interest rates. The old protectionist system was dismantled and in 1865 the staunch free trader Gripenstedt made Sweden a member of the trade treaty between France and Great Britain—a treaty with a most-favoured-nation clause, which gave each participant maximum access to the others' markets and was consequential in opening Europe up to trade.

Freedom of the press and religion were dramatically expanded. Women won the rights to own and inherit property, get an education, and have a career. The controls on the internal movement of people were abolished in 1860, and since the zeitgeist was so liberal, the government took the chance to broaden that freedom to include immigration and emigration. The primary result was the start of a great wave of emigration to America, an

exodus of around a million Swedes. Some would return with new ideas and others wrote home about their experiences, both of which spread the latest ideas about democracy, culture, and technology to Swedes still living in their home country.

Those ideas were not all centred on abolishing government intervention. In 1842, Sweden introduced mandatory elementary education. The old school system, which had as its mission the turning of upper-class students into priests or civil servants, was replaced by a practical education for everyone. Gripenstedt's government also took the controversial step (opposed by some radical liberals) of building a national railway system funded with government loans. The moderate liberals argued that government funding of public goods that benefited everyone, like basic education and a main railway line, was legitimate, while government intervention to benefit one group at the expense of others was not. That is why they supported the state building the main lines, but wanted local railway lines to be built and funded privately.

Traditionally, historians consider 1865 as the apex of the most intense reform period. That year saw the abolishment of the old parliament, based on the four estates, and in its place the institution of a new, slightly more democratic parliament, where power lay with the farmers.

In January 1867 the new parliament assembled for the first time and Lars Johan Hierta, the oldest member of parliament, delivered the welcome speech. He celebrated the reforms and warned the members not to come up with any schemes to take money out of people's pockets. One prominent observer commented: "Now there are no parties. Everybody is a liberal nowadays" (Hasselberg, 1945: 232).

### The liberal era 1870-1970

*All major political forces accept an open economy based on secure property rights. Sweden industrializes rapidly and experiences 100 years of growth. A modest welfare state emerges, but the public sector is still smaller than in other European countries.*

Gripenstedt's reforms were often hotly contested, and some even accused him of leaving office once Swedes were about to see the devastating effect those reforms were going to have on Sweden's economy. However, eventually both the old conservatives and the new labour movement came to accept the "Gripenstedt System," at least in its fundamentals, because the concept proved to be viable. Now that work and entrepreneurship were legal and rewarded, the "poor sophisticate" got to work.

The reforms—protected property rights, freedom to start businesses, and freedom to trade—gave Sweden 100 years of growth at a rate that no other European country equaled, just as Gripenstedt had predicted. Indeed, the only country in the developed world that exceeded Sweden's 8.5-fold increase in per capita income between 1870 and 1970 was Japan, though only by a photo finish.

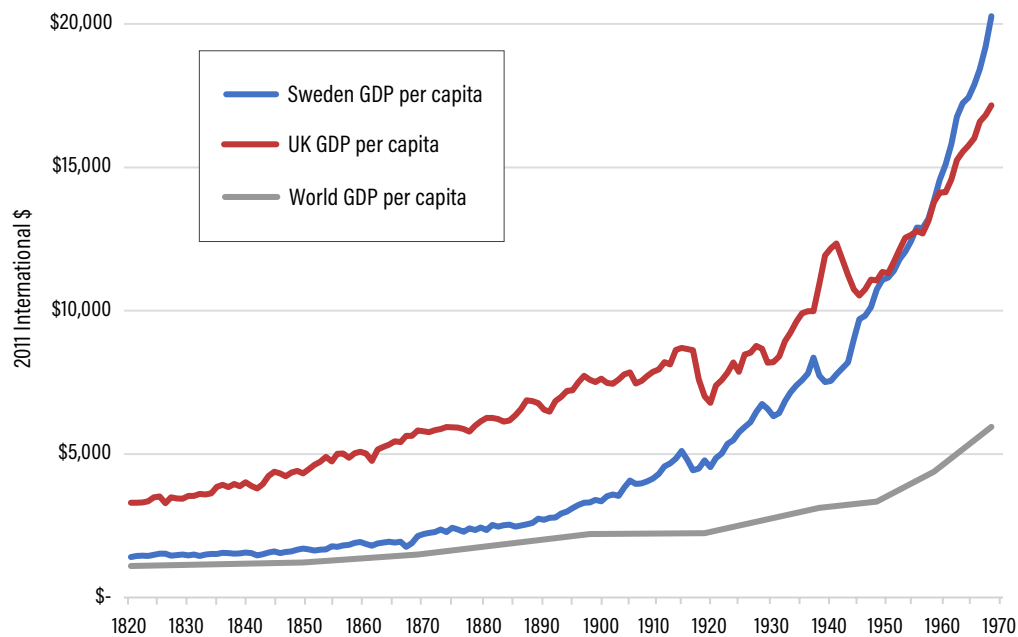
Consider Figure 1.1. It shows per capita GDP in Sweden, the UK, and the world from 1820 through 1970. At the beginning of the period, per capita GDP in Sweden was less than half that of the UK. By the 1950s, per capita GDP in the two nations was equal, and by 1970, Swedish per capita GDP exceeded that in the UK by nearly 20 percent.

Figure 1.2 lists per capita GDP by nation in 1870 while Figure 1.3 shows this same figure in 1970. In 1870, Swedish per capita GDP lagged far behind that in the UK and much of the rest of Western Europe. By 1970, however, only the US, Switzerland, and the oil sheikdoms enjoyed substantially higher per capita GDP levels than Sweden.

Figure 1.4 expands on Figure 1.1 by showing the growth in real per capita GDP from 1870 through 1970. It shows that only Japan and Saudia Arabia achieved faster growth over this 100-year period. But recalling Figure 1.3, note that despite their rapid growth, both of these countries were still significantly poorer than Sweden in 1970 (Japan's per capita GDP was 76 percent of Sweden's while Saudia Arabia's was 60 percent of Sweden's). Thus, Sweden is unique over this period as the only rapidly growing nation to also achieve a high income level. This is no easy feat.<sup>2</sup>

The first noticeable change between 1870 and 1970 was that this country rich in natural resources began to put its resource wealth to better use and develop new technologies to extract and process them. Small capitalist farmers started investing in more efficient agriculture. The forest industry, which now had permission to export its output, developed the infrastructure to export the “green gold.” From the early 1900s pulp became a

**Figure 1.1: GDP Per Capita in Sweden, the UK, and the World (1820-1970)**

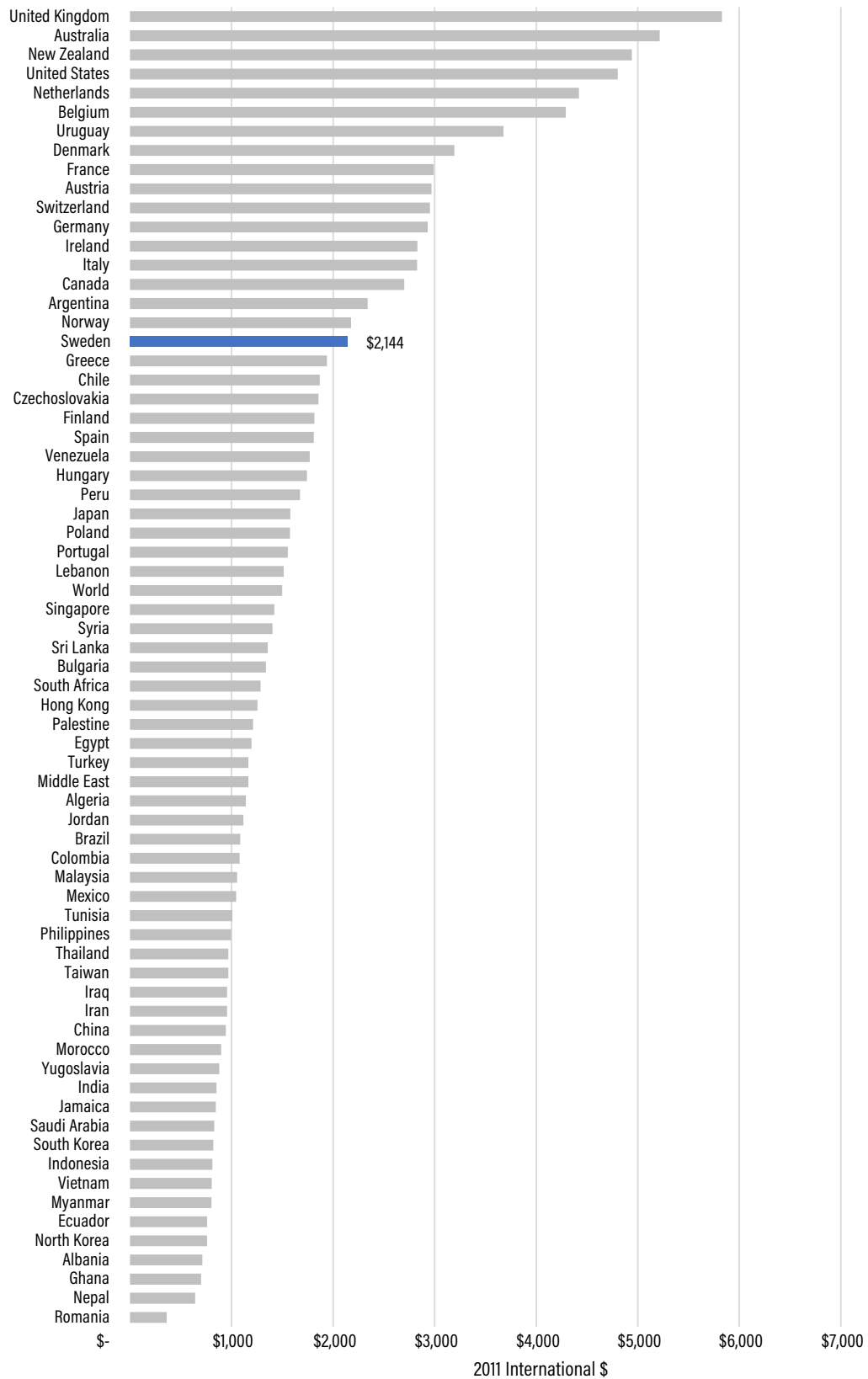


Source: Bolt and van Zanden (2020).

Note: GDP per capita adjusted for inflation and price differences between countries.



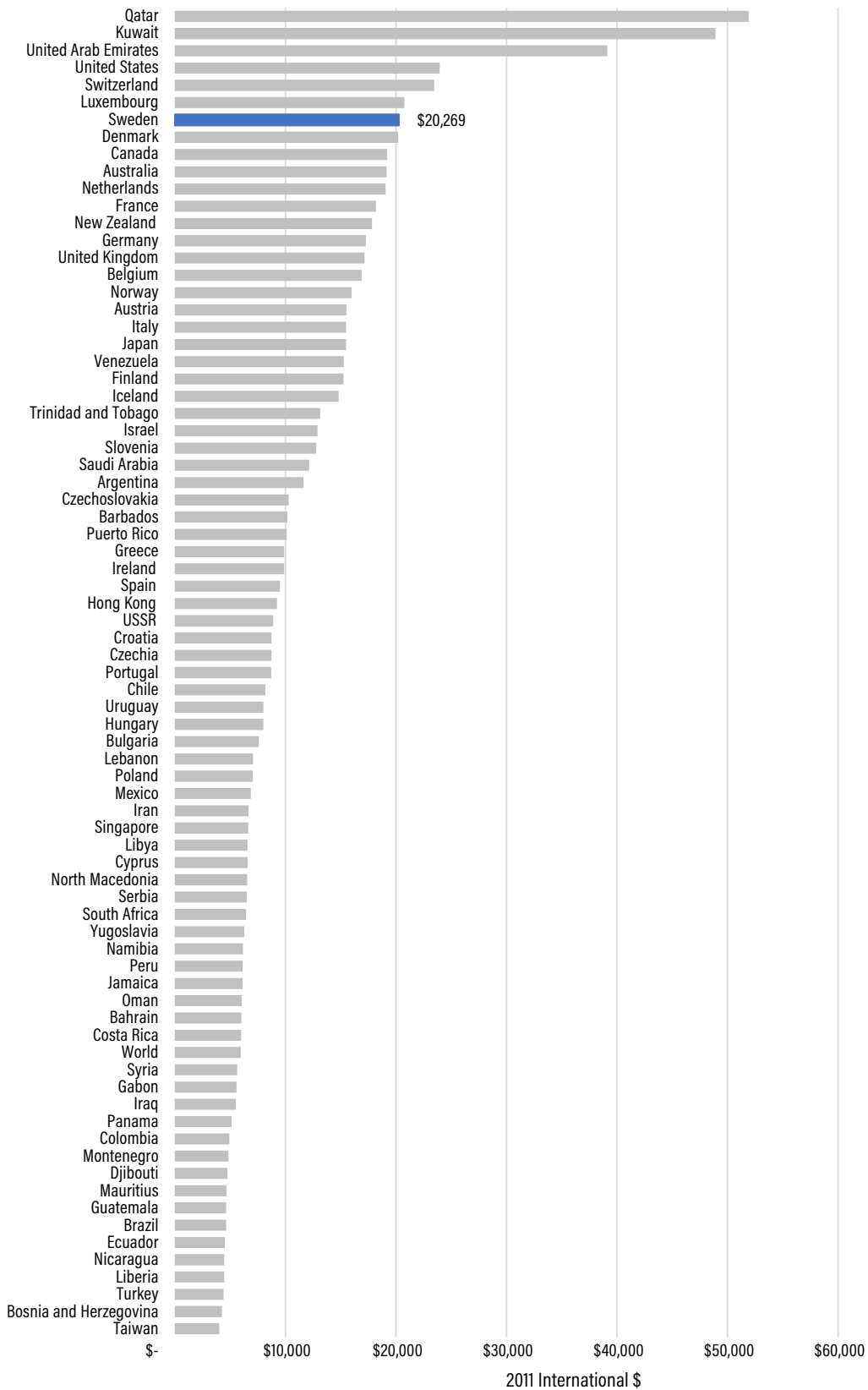
Figure 1.2: GDP Per Capita (1870)



Source: Bolt and van Zanden (2020).

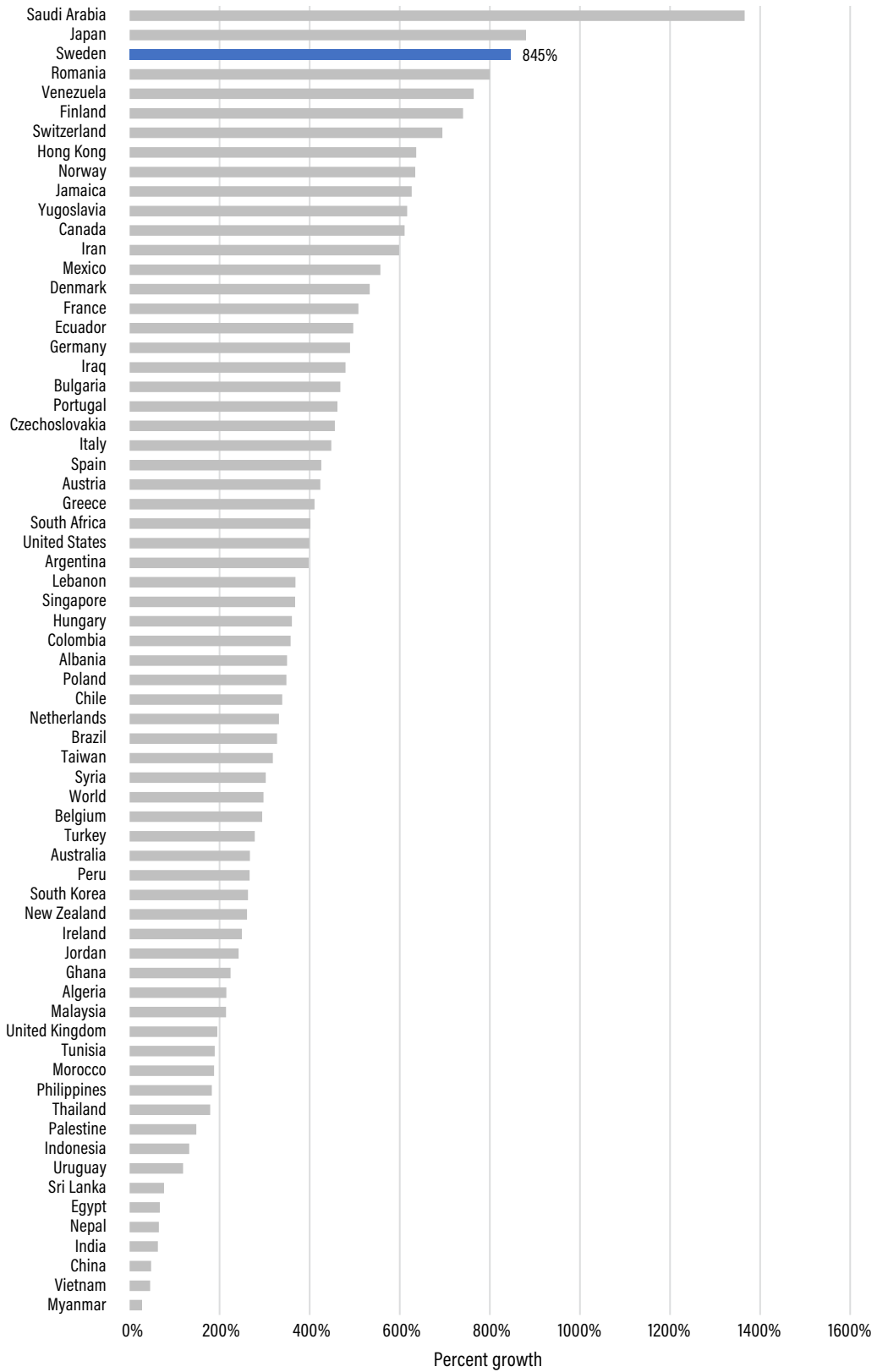
Note: GDP per capita adjusted for inflation and price differences between countries.

Figure 1.3: GDP Per Capita (1970)



Source: Bolt and van Zanden (2020).  
 Note: GDP per capita adjusted for inflation and price differences

Figure 1.4: Growth in Real GDP Per Capita (1870–1970)



Source: Bolt and van Zanden (2020).

Note: GDP per capita adjusted for inflation and price differences between countries.

bigger export than timber. After deregulation and before the First World War, ironworks doubled the production and export of iron and steel. Restructuring reduced the number of ironworks by more than 60 percent, but production at each one increased 10-fold (Schön, 2000: 325).

Craftsmen, liberated from the old guild system, began competing by using new methods, offering new goods and designs, and at lower prices. The old trades were mechanized, and factories started mass-producing goods that even the poor could afford. The new financial system channeled capital to the most efficient producers, and Swedes used export revenue and profits to invest in new machinery and methods.

This laissez-faire epoch engendered a unique concept: *snilleindustrierna*—the “genius industries,” a term referring to businesses founded on an ingenious invention or the commercialisation of one, producing on a massive scale and largely for export. This was the start of Sweden’s era of multinational business.

These genius industries were often established by polymaths who were both inventors and industrialists. Lars Magnus Ericsson invented an automatic telephone exchange and founded the multi-national Ericsson company. Sven Wingquist invented the self-regulating ball bearing and created SKF. Alfred Nobel invented dynamite and built up Nitroglycerin AB (later Dyno Nobel). Gustaf Dalén invented a flashing apparatus for lighthouses and founded AGA. Gustaf de Laval’s milk-cream separator was the basis for a company that is now famous under the name Alfa Laval. Other Swedish entrepreneurs commercialized other people’s inventions: Ludvig Fredholm started ASEA (now ABB) to sell electrical lighting and generators, and Axel Wenner-Gren built up Electrolux by introducing vacuum cleaners and refrigerators to Swedish homes.

Soon, this first generation of entrepreneurs was followed by many others who sprang up from the new industrial working class. The private sector was not the only sector playing a part in Sweden’s rapid advancements; the government contributed by providing good basic schooling and sophisticated higher education in technology and natural science, which gave Sweden both breadth and excellence. This was clearly one instance when the public sector supported the private sector rather than undermined it. Helping Swedish industry compete with the most advanced methods and technologies early on in its development was a burgeoning international economy and little prejudice against practical skills. Sweden’s success was quite an astonishing achievement for such a poor country.

The growth in Sweden’s annual GDP per capita accelerated to 1.7 percent between 1870 and 1910, almost as fast a growth as in the United States (1.9 percent). Real wages increased even faster, during a period when many Swedes were emigrating to America and Swedish natural resources were attracting foreign capital. Real wages between 1870 and 1910 increased by a remarkable 2.8 percent annually, compared to an average of 1.1 percent for the US, Britain, France, and Germany. At 2.6 percent only Norway and Denmark came close to Sweden’s real wage growth (Schön, 2000: 225).

The growth in per capita GDP increased the demand for labour-saving machines. Sweden was starting to transform itself from an agricultural economy into an urbanized, industrial economy with a growing working class. Despite rapid population growth in the country, the rural population declined by a tenth between 1870 and 1910 (Rojas, 1996: 30).

The 1880s saw a long and vicious struggle over grain tariffs, which split the then dominant *Lantmannapartiet* (“Rural Men’s Party”) and gave rise to a new political landscape composed of free traders on the left and protectionists on the right. Cheap food imports had ended the recurring famines that once plagued Sweden, but farmers did not appreciate the competition. Bismarck’s protectionist Germany was in the ascendant and tariffs in Germany and France applied to foreign goods led to calls for retaliation. The protectionists grew stronger and in 1888 a conservative government took over with a new majority in Sweden’s parliament. It proceeded to implement import tariffs on both agricultural and manufactured goods.

In economic terms, the new tariffs were not as consequential as the free traders had feared and the protectionists hoped. They were not adjusted for inflation and so declined in real terms, and the dramatic reduction in transport costs from the country’s increased use of steamships and railways more than offset the loss from the tariffs. Sweden’s trade continued to grow. Between 1890 and 1910 Sweden’s exports grew by 3.7 percent annually (Schön, 2000: 227).

However, the tariffs had political consequences. The classical liberal idea that government should be a rule setter and neutral arbiter was dead. If landowners could pick the pockets of consumers, why shouldn’t other classes organize to take what they wanted? One historian writes: “After the protectionist victory, parliament was drowned by a wave of proposals that had in common that they all wanted the government to intervene both here and there” (Kilander, 1991: 205). In 1889 the Social Democratic Party was founded on a free trade platform, but also on the idea that workers shouldn’t be content with just waiting for the rewards of economic growth. They should also seize the means of production. Many liberals were sympathetic to the workers’ frustrations and began to accept limited forms of social protection. In April 1888, the liberal newspaper *Dagens Nyheter* wrote: “State socialism [tariffs] which benefits the powerful, by necessity demands state socialism that benefits the small and weak as well” (Hasselberg, 1945: 345-348).

The rise of new conservatives and social democrats did not spell the end of the Gripenstedt System. Until 1930, public spending did not surpass 10 percent of GDP. In a small economy dependent on imports and exports with competitive international companies, both capital and labour saw the importance of an open economy. And the limited government model produced impressive social and economic outcomes. Conservatives modernized their policies in a pro-business direction. Where they had once said that a strong and interventionist government would hold industrialization back, now they said that only such a government could protect and guide the industrialization of society. During the election campaign of 1911, the new conservative party even claimed to represent a middle



way between classical liberals and the new social liberals who supported various forms of social protection.

The social democrats also adapted, as they saw the success of the liberal economy and were influenced by economists like Knut Wicksell, Gustaf Cassel, and Eli Heckscher, who explained the importance of free enterprise and an open economy. Socialism turned out not to be a vote winner, and Sweden's rapid growth suggested another path: Instead of killing the goose that laid the golden eggs, they pointed out that those eggs might be sufficient for all classes, but under a different form of distribution.

In a highly influential 1926 book the young social democrat Nils Karleby urged fellow socialists to abandon their obsession with ownership. Socialism should be a guiding principle not merely an organizational form. In Karleby's view, socialists should use the power of the market—competition, prices, and the profit motive—to create as much wealth as possible, but focus on redistributing the rewards through taxation and a combination of government-provided social services and income support programs. Karleby's perspective was so important for social democrats that when one future prime minister, Ingvar Carlsson, was called in 1958 by then prime minister Tage Erlander to interview for a job, Erlander had just one question for him: "How well does Carlsson know his Karleby?" (Westerholm, 2018).

During the 1920s, under the leadership of Per Albin Hansson, the social democrats were transformed from a party of class war and socialism into a patriotic party for all classes. Hansson's vision was *Folkhemmet*, "The people's home" (a concept that radical conservatives had previously used)—a unified people under a paternal but caring and tolerant government. The social democrats started portraying themselves as the inheritors of the Swedish tradition of consensus politics and piecemeal democratic change. Their approach was very different from that of working class parties on the continent who tried to confront the capitalist system head on.

A groundbreaking new agreement for the labour market soon came to be seen as a central part of the Swedish model. During the early 1900s Sweden was one of the countries with the most work days lost to strikes and lockouts. The government planned to intervene, but both employers and unions wanted to prevent it from setting rules and wages. In 1938, the main trade union confederation LO and the employers' association concluded a national framework in Saltsjöbaden that set rules for negotiations and industrial action and gave the LO secretariat the power to suspend conflict aid to member unions that did not abide by compromises. The tradition of consensus and compromise that framework launched has been called the "Saltsjöbaden spirit," and is credited with changing the Swedish labour market from being wild and confrontational to being generally peaceable.

In 1932, the social democrats formed a government and held power until 1976 (except for three months in 1936), an incredible 44-year stretch. Some observers, like Herbert Tingsten (who abandoned socialism after having read Hayek's *Road to Serfdom*), suggested that the social democrats could only hold onto power so long because they lacked a soul.

In his view, they were shape shifters who turned into whatever the voters wanted for the moment. But another way of seeing their success is that they were Karlebyans who didn't care much about the basic organization of the economy as long as it delivered the goods that they wanted to redistribute. As Mauricio Rojas puts it: "The focus was no longer on transforming the factories, but people's lives outside the factories" (Rojas, 1996: 37).

Slowly but steadily the government took on new powers and responsibilities, but at its heart it remained a limited form of redistribution on top of a free market economy. Describing the situation in 1938, the minister of finance, Ernst Wigforss, explained that the government had only aimed for a "modest reform program," and that "the size of our assets had to be considered before we could recommend further steps along this path" (Wigforss, 1980: 296). Until the Second World War, income taxes were flat for most Swedish workers at a rate of around 15 percent.

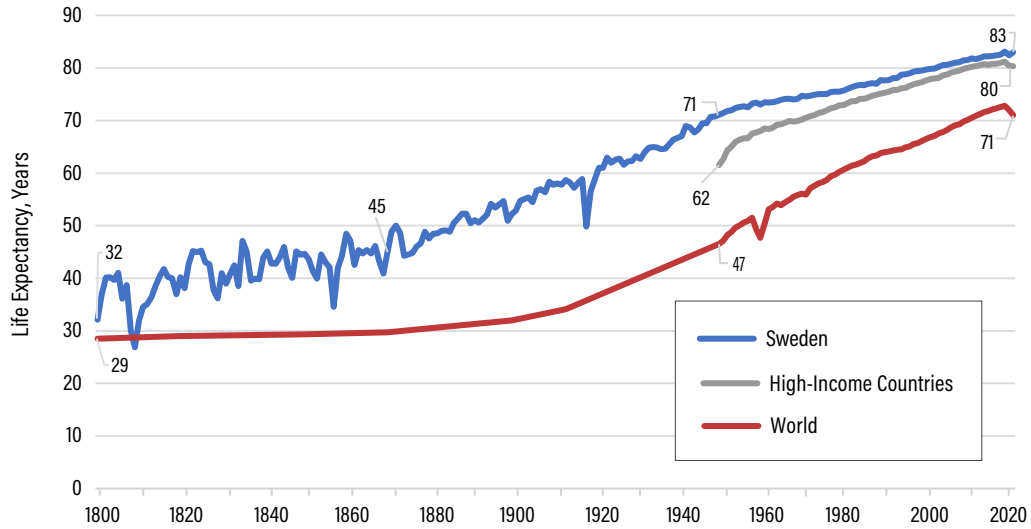
The modest welfare state was also a consensus project and even though the social democrats often led the way, the opposition soon caught up. After having studied 61 significant votes on government expansion in the Swedish parliament during the 20<sup>th</sup> century, the political scientist Emil Uddhammar concludes that in only 27 percent of the cases did any center-right party express a reservation. Indeed, the opposition often wanted even more spending on their pet projects. For example, the conservatives wanted more child benefits and the social liberals more support for child care. When center-right parties, in a major break with free market principles, gave the farmers' central organization monopoly rights to control the price of milk in 1932, the only opponents were the social democrats (Uddhammar, 1993).

However, milk was an exception. Interventions were still limited and the economy delivered enough to make them sustainable, especially during and immediately after the Second World War when neutral Sweden with an intact industrial base could export products to countries destroyed by the conflict. Economist Mancur Olson thinks that one reason why Sweden's interventions did not harm the economy was that its interest groups represented a large share of the country's economic capacity. Narrow interest groups tend to lobby for specific favours and subsidies, but larger, all-encompassing organizations know that their members are affected by the policies they propose and, therefore, they have an incentive not to hurt the country's productive capacity. They therefore tend to lobby for interventions that are general and support the economy at large, for example education and infrastructure, rather than tariffs and subsidies (Olson, 1990). Compared to its international counterparts, the Swedish Employers Confederation has been more pro-market than pro-business, arguing for less regulation and low taxes rather than industry-specific favours. The main trade unions have been much more willing to accept free trade and creative destruction to benefit the economy as a whole than have their counterparts in other countries.

In 1950, with the Gripenstedt System largely intact and after having stayed out of two world wars, Sweden had achieved the fourth highest per capita GDP in the world, just behind the United Kingdom to that point. Sweden was by then a success story, the

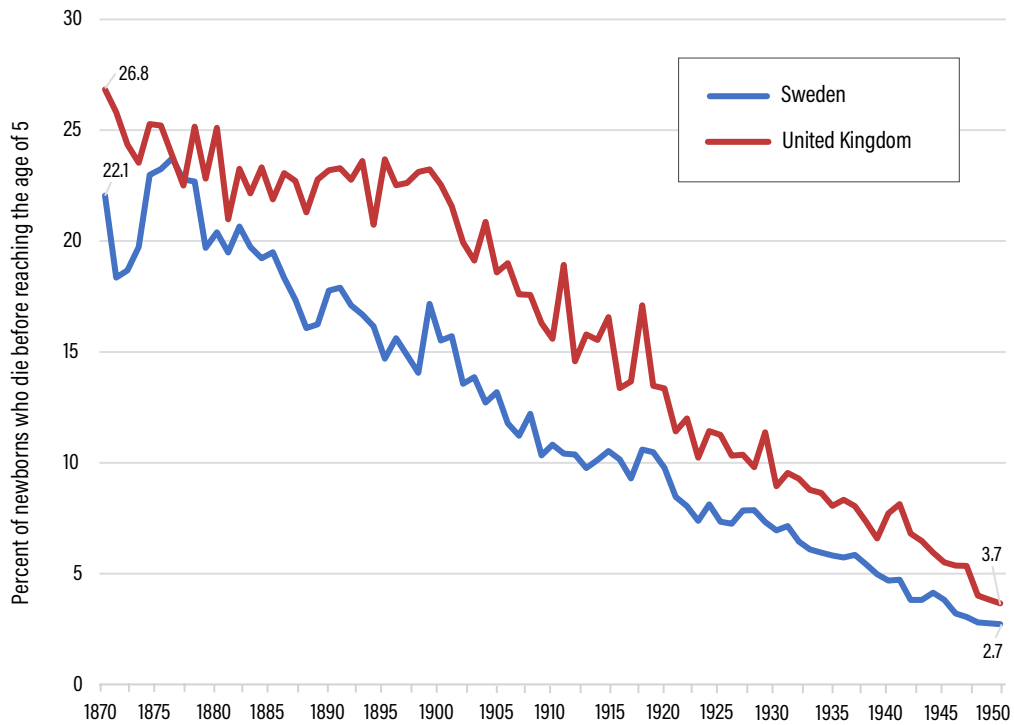
envy of the world. Between 1870 and 1950, life expectancy had increased from 45 to 71 years (see Figure 1.5). Child mortality declined from 22.1 to 2.7 percent (see Figure 1.6). Maternal mortality declined by over 90 percent (see Figure 1.7) (Our World in Data, 2022b; 2019).<sup>3</sup>

Figure 1.5: Life Expectancy at Birth (1800–2021)

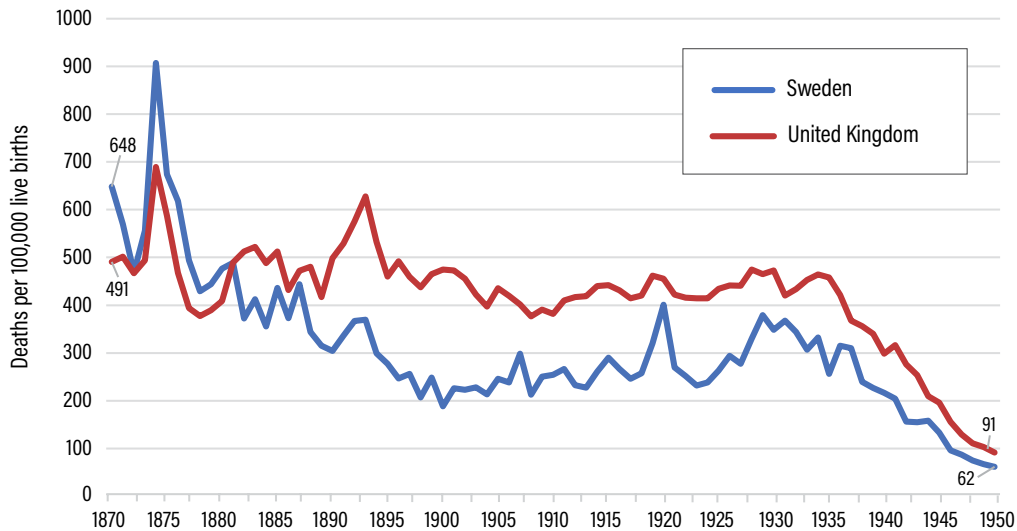


Source: Our World in Data (2022a).

Figure 1.6: Infant Mortality (1870–1950)



Source: Our World in Data (2019).

**Figure 1.7: Maternal Mortality Rate (1870–1950)**

Source: Our World in Data (2022b).

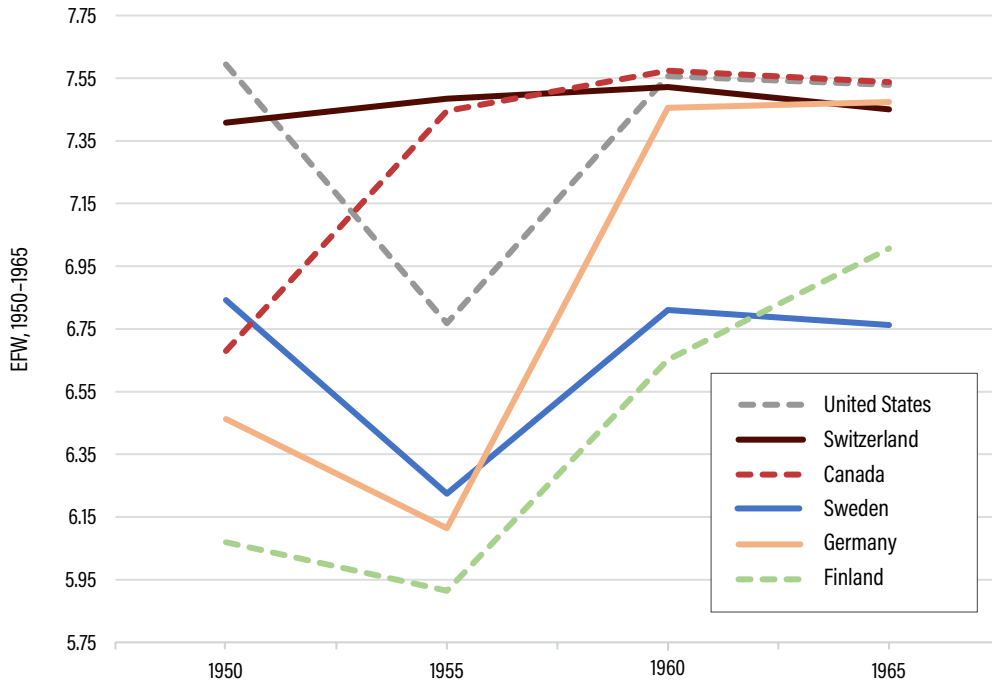
Note: The maternal mortality ratio is the number of women who die from pregnancy-related causes while pregnant or within 42 days of pregnancy termination per 100,000 live births.

Big government was still no more than a glint in the politicians' eyes. The government had created a number of income support programs for the poor and old and it subsidized education and infrastructure. But those interventions were generally limited and mostly designed to support an open market economy rather than undermine or replace it. With a few exceptions, like the milk cartel, the economy was decentralized, run bottom-up through voluntary decisions by individuals and businesses with the consequences being borne largely by the decision-maker. In this sense, Sweden was by the mid-1900s clearly a "capitalist-inclined economy," to borrow the terminology suggested by Jim Ottesen in the introduction to this series.

In 1950, Sweden was the third freest economy in the developed western world, after the United States and Switzerland, according to attempts to extend the Economic Freedom index retrospectively (see Figure 1.8) (Lawson and Murphy, 2019).<sup>4</sup> Public spending as a share of GDP, shown in Figure 1.9, was below 20 percent, well below countries like Britain, France, and West Germany. Taxes as a share of GDP were slightly lower than in the United States, and the highest marginal tax rate was 20 percentage points lower than in that country (Bergh, 2022: 50, 58).

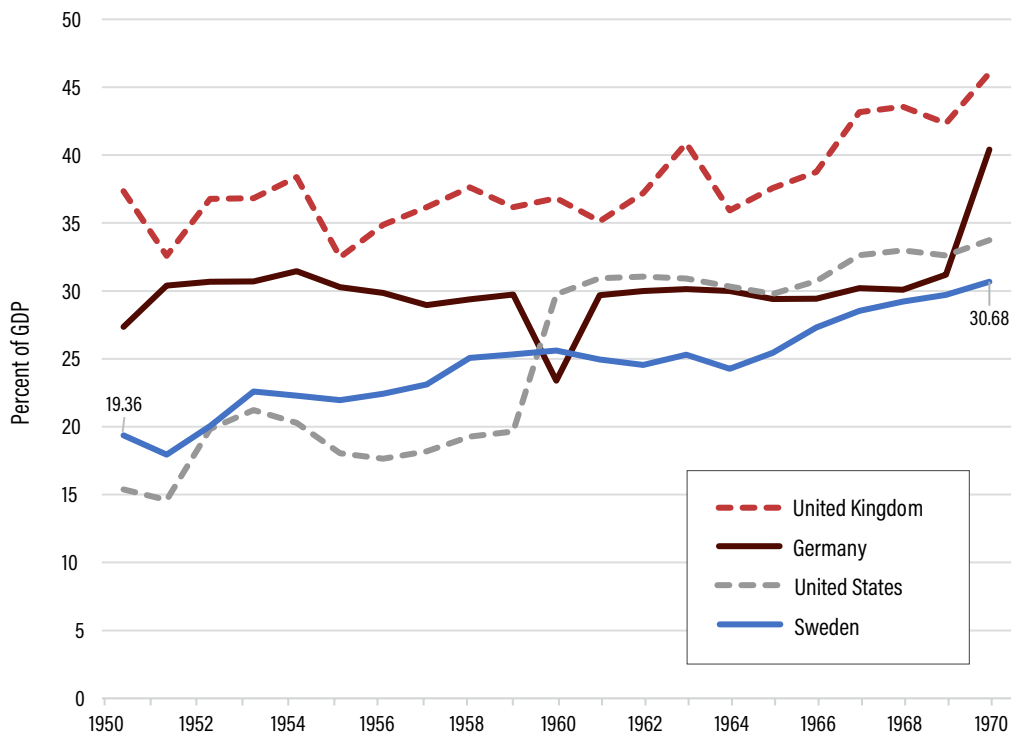
In other words, Sweden was one of the richest, healthiest, and most successful societies the world had ever seen—and that was before it was a generous welfare state and had started experimenting with socialist ideas. But that very sense of unequalled wealth and almost automatic progress is key to understanding what came next. After 100 years of growth, Swedes started to take their good economy for granted and forgot where it came from. It became difficult to resist calls for even more redistribution and a government program for every social problem. Prime Minister Tage Erlander has talked about "the

Figure 1.8: Economic Freedom (1950-1965)



Source: Lawson and Murphy (2019).

Figure 1.9: Government Expenditures as a Share of GDP (1950-1970)



Source: Mauro, Binder, and Zaman (2015).



dissatisfaction of raised expectations.” As people get more, they want even more, and the Social Democrats responded to this the only way they could. So began Sweden’s brief but consequential experiment with socialist policies.

### Notes

- 1 I have written extensively on Sweden’s classical liberal history in Norberg (1998).
- 2 Due to both simple mathematics and “catch up growth,” it is easier for relatively low-income small economies to grow rapidly than it is for high-income large economies to grow rapidly.
- 3 The maternal mortality ratio is the number of women who die from pregnancy-related causes while pregnant or within 42 days of pregnancy termination per 100,000 live births.
- 4 According to this index, Honduras, Sri Lanka, and Mauritius in the developing world also beat Sweden in 1950.

## THE RISE AND DECLINE OF SOCIALISM

For a long time, the economist and Nobel laureate Paul Krugman had a stock answer to the question of what kind of society he wanted: “Sweden in the summer of 1980” (Krugman, 1999). He thought that Sweden had by then found the perfect middle way between free markets and government intervention.

Not that it satisfied everyone. In 1980, Francois Mitterrand, who would be elected French president just a few months later, complained that Swedish socialism was not enough:

Sweden is insufficiently socialistic, for despite an unparalleled redistribution of income among social groups, it has not struck capitalism a mortal blow, in the heart of its power: the ownership of the major means of production. (Revel, 1982)

Sweden never became a textbook socialist country, with the means of production in government hands. Social democrats considered taking control of big business with the “Employee Funds,” a labour union plan from 1976 in which a portion of company profits taxed by the government were to be used to buy shares in Swedish companies with the goal of transferring those companies from private hands to collective ownership, but it was rejected by public opinion and watered down substantially after an ambitious campaign from business groups. However, the whole climate of ideas in Sweden was infused by socialist ideas in the 1970s and ’80s, ideas both inherent in the social democratic project and some from external forces. And a system of tight regulations, price controls, and tax increases rapidly centralized the economy. Decision-making that had previously been decentralized to individuals and businesses was now taken over by politicians and government authorities, and the consequences—good or bad—were born by taxpayers collectively rather than by those who had made the decisions. In this regard, and to use Jim Ottesen’s terminology, in the 1970s, Sweden changed from being a capitalist-inclined economy to being a socialist-inclined economy.

### The Socialist era: 1970-1990

*Sweden experiments with socialism, the public sector expands rapidly, the government raises taxes and regulates the labour market. Sweden loses businesses and entrepreneurial talent and economic growth declines.*

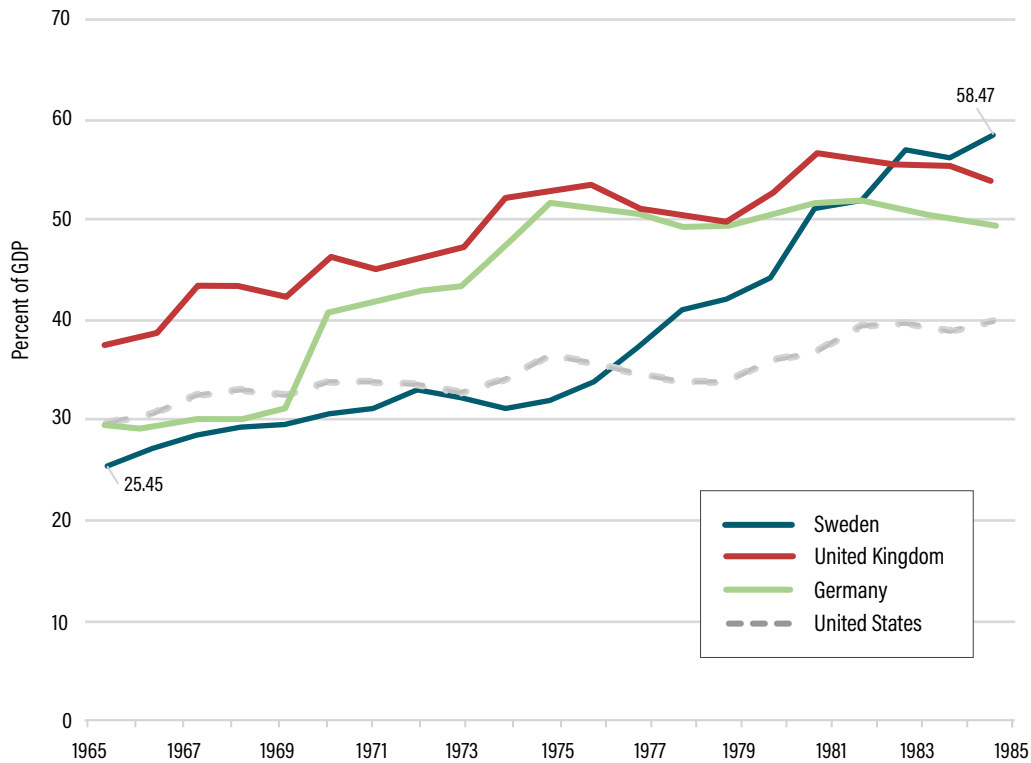
The government line from Nils Karleby's days, often echoed by the opposition, was always to redistribute as much as the economy could afford, and most of the debate centered on different opinions about how much redistribution the economy could bear and how fast. In the 1960s Sweden was on top of the world. The country had globally admired companies, an educated work force, and an open and competitive economy that delivered high growth, decent profits, and higher wages. And as late as 1970 total public spending as a share of GDP was lower in Sweden than in countries like the United States, Britain, and West Germany. The conclusion many drew was that now the economy could afford a very big government indeed. The time for patience was over.

The social democrats were also taken aback by the strong socialist current among students and intellectuals in the late 1960s, and their attempts to build alliances with the working class. Social democrats were used to an intellectual hegemony after having been in power since 1932, but now they were under strong pressure from outside forces to do more than just administer progress. Under Prime Minister Olof Palme, the social democrats responded by throwing caution to the wind. Tellingly, it eventually turned out that almost no leading social democrat really believed in the Employee Funds because by undermining the whole system of private enterprise it risked killing the goose that laid the golden eggs. One of Palme's ministers even claimed that Palme did not think such funds belonged in a democratic society (Pettersson, 2002). In a scandalous episode, on the eve of the parliamentary vote on introducing the funds, a photo journalist captured the finance minister scribbling a poem about them, deriding them as "shit." The social democrats almost nationalized Sweden's biggest companies against their better judgment, just to make sure that they were not outflanked on the left.

The government now socialized consumption faster than ever, which led to an unprecedented expansion in the size of government. In just 20 years, public spending more than doubled, from 25.4 to 58.5 percent between 1965 and 1985 (see Figure 2.1) (Our World in Data, Undated). This came primarily from a rapid expansion of social services like health care, elderly care, and child care, and transfers like pensions and housing allowances. The marginal tax rate for blue collar workers increased from less than 40 percent in 1960 to more than 60 percent in 1980, and for white collar workers to above 70 percent. The payroll tax rose from 12.5 percent in 1970 to 36.7 percent in 1979 (Myhrman, 1994: ch. 6). Capital gains were taxed as income, at progressive rates. In a series of steps, the corporation tax increased to almost 60 percent in the 1980s, even though it also offered generous deductions.

At the same time, the government raised the costs of doing business with a whole battery of regulations aimed at solving every conceivable problem and inequity. In 1970, Sweden introduced an opaque system of price controls, which forced businesses to negotiate price changes with business groups and government authorities. When Sweden devalued its currency it often implemented temporary bans on all price increases. Now it also gave up on the traditional Sweden model where labour market affairs were left to negotiations between business organizations and trade unions. Starting in 1974, the government regulated labour protection substantially, defining lawful reasons for termination and

Figure 2.1: Government Expenditures as a Share of GDP (1965–1985)



Source: Mauro, Binder, and Zaman (2015).

requiring that workplaces needing to fire staff for redundancy do so according to seniority (“last in, first out”).

As Mitterrand is sometimes quoted as telling Swedes, perhaps apocryphally: “In France, we socialized corporations and liberated people; you did the reverse.”

It is not difficult to understand why foreigners were fascinated by the Swedish experiment of the 1970s. Here was a small country that experimented with socialist ideas, at least in terms of extensive regulation of businesses and very high taxes, and yet it seemed to be oddly successful. Far from desperately poor, it was one of the richest countries in the world, with successful export companies, high employment rates, and impressive levels of trust among individuals and between individuals and government. Those who were learning about Sweden for the first time confused the long-lasting preconditions that made the experiment possible with the outcome of it; they failed to see that this experiment was, in fact, starting to erode some of those preconditions and had run into problems almost from the start. It was like the old joke: “How do you end up with a small fortune? Start with a large one.”

The oil crisis of 1973-74 revealed a productivity crisis throughout the western world. In Sweden, self-assured politicians, endeared to a vulgar form of Keynesianism, responded by

trying to bridge the recession with a massive stimulus program that supported both extra demand and production for stockpiling. In this overheated climate, wage and payroll tax increases raised labour costs by 40 percent in just two years, 1975 and 1976. The result was a cost crisis that almost destroyed Swedish manufacturing and exports. Just as the rest of western Europe rebounded from the crisis and the export giant Sweden should have prospered, it entered a deep recession. From 1974 to 1977, steel production in the country decreased by 30 percent, shipbuilding by half, and much of the textile and mining industries collapsed (Magnusson, 1996: 476).

While Sweden used to welcome and facilitate restructuring, now the government doled out massive corporate subsidies to keep workers employed. This policy continued from 1976 to 1982 under center-right governments (see Table 2.1), at which time the social democrats finally lost power—but not the battle of ideas. Critics talked about the government’s “industrial emergency room,” where failed businesses were given a few extra years of life at an enormous cost to taxpayers. In 1977, the ship-building industry was in effect nationalized (and phased out) and in 1978 much of the steel industry was taken over by government and only returned to modest profits and eventual privatization after almost half of the workforce was let go and most of the plants and product lines were eliminated.

**Table 2.1: Political Affiliation of Swedish Governments**

Years	Political Affiliation
1945-1976	Social Democratic
1976-1982	Center-Right coalitions
1982-1991	Social Democratic
1991-1994	Center-Right coalition
1994-2006	Social Democratic
2006-2014	Center-Right coalition
2014-2022	Social Democratic/Green coalition

The one consistent policy that various governments have used to try and make their economies more competitive is to devalue the currency. In Sweden, the currency was primarily fixed against the deutsche mark and eventually the European Currency Unit (ECU), the European Economic Community’s basket of member country currencies. In 1976, the Swedish krona was devalued by 3 percent, in April 1977 by 6 percent, and in August the same year by an extra 10 percent. In September 1981 it was devalued by 10 percent, and finally, in 1982, just after the Social Democrats had returned to power, it was further devalued by a whopping 16 percent.

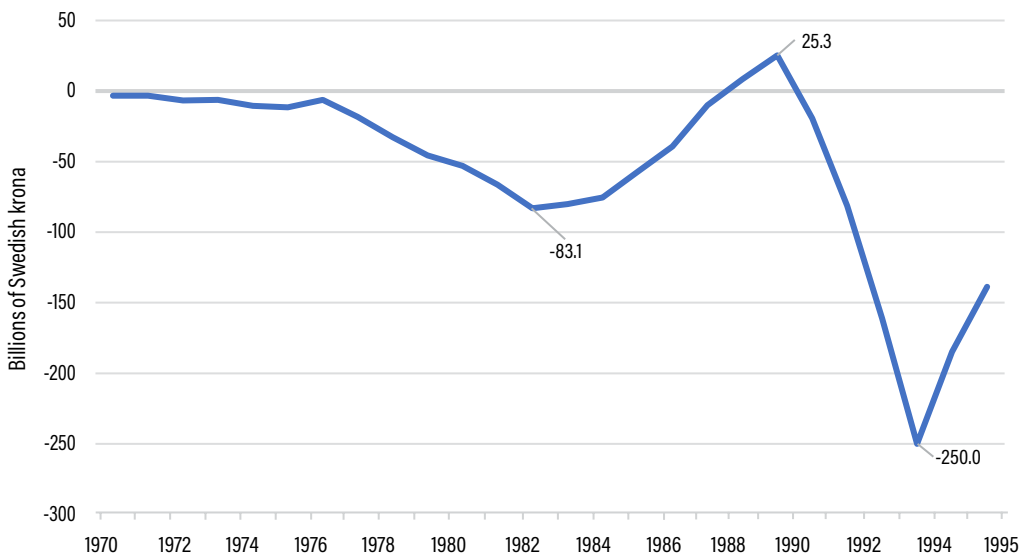
These devaluations, some of which had to be undertaken simply because trade unions immediately demanded higher wages to compensate workers for the last devaluation, undermined the purchasing power of Swedes. In combination with the international economic boom of the 1980s, the 1982 super devaluation hid many of the structural

problems in the Swedish economy, problems that would come back with a vengeance in the early 1990s. Unions soon returned with demands for higher compensation, and inflation surged. The devaluations did boost the export sector, but in an erratic, unpredictable way that undermined long-term investments and distorted the price mechanism. Instead of letting market forces encourage productive companies and punish uncompetitive ones, all export companies were given an irregular boost of performance-enhancing exchange rate changes, while devaluations protected unproductive domestic businesses from imports. The Swedish export share of OECD markets continued to slip, however, and between 1970 and 1990 dropped by almost 30 percent.

Fewer companies were created in Sweden and the ones already in existence did not expand. In fact, by 1990, the Swedish economy had not created a single net job in the private sector since 1950, even though the population had increased by one and a half million people. All employment creation took place in the public sector (Davidsson and Henrekson, 2002). As Figure 2.2 shows, the Swedish government ran budget deficits every year from 1970 to 1987. Public debt, shown in Figure 2.3, increased from less than 18 percent of GDP in 1970 to over 70 percent in 1985 (IMF, 2023).

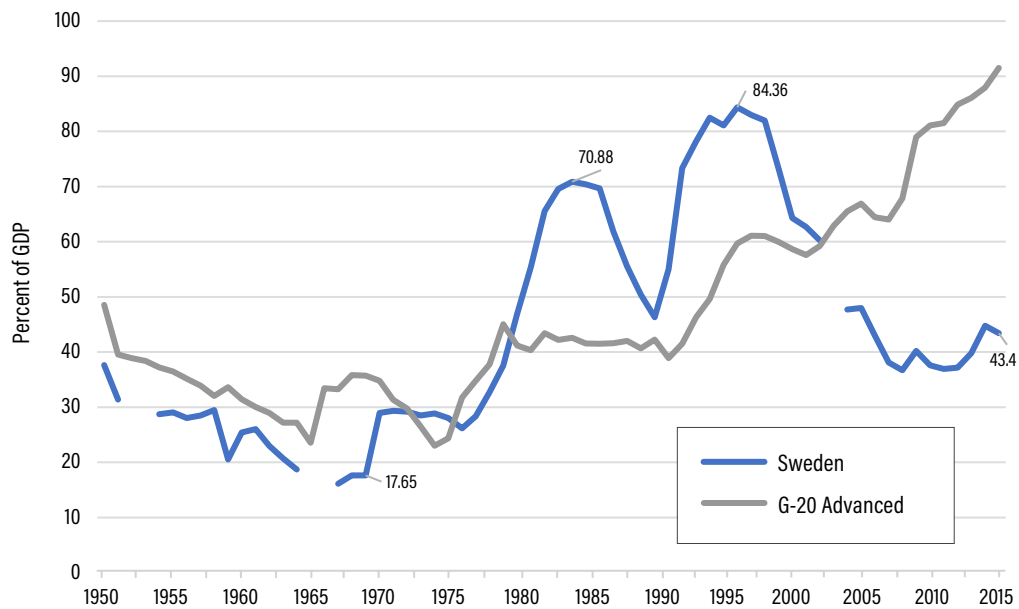
This is the one period in modern history when Sweden lagged behind other industrialized countries on many measures. The rate of investment declined from a couple of percentage points above the OECD average to a couple of percentage points below. Figure 2.4 shows productivity growth, as measured by GDP per employee. Swedish productivity increased by an average of 4.6 percent per year from 1960 to 1970, but it only increased by an average of 2.0 percent per year from 1970 to 1990. Over this same period, OECD average annual productivity growth was 3.2 percent per year (Feenstra, Inklaar and Timmer, 2015).

Figure 2.2: State Budget Balance (1970-1995)



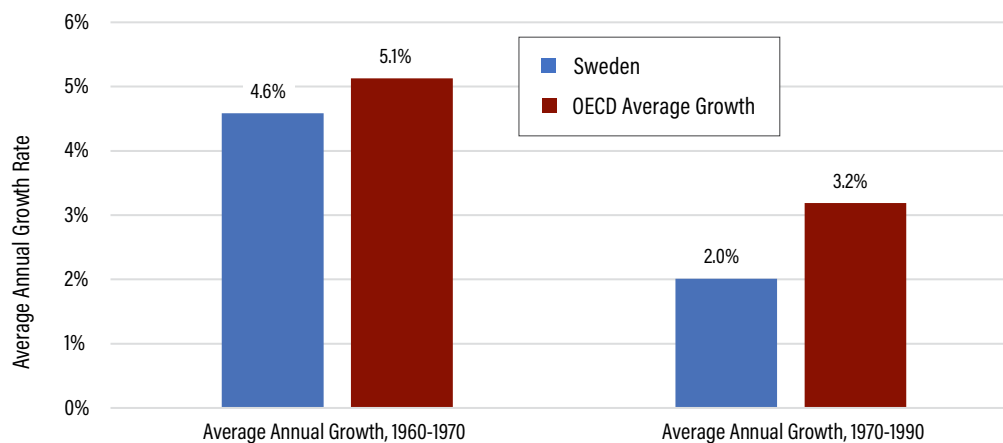
Source: Öljemark (2022a).

Figure 2.3: Public Debt as a Percent of Gross Domestic Product (1950–2014)



Source: OMF (2023).

Figure 2.4: Average Annual Growth in Productivity Per Worker (1960–1970, 1970–1990)

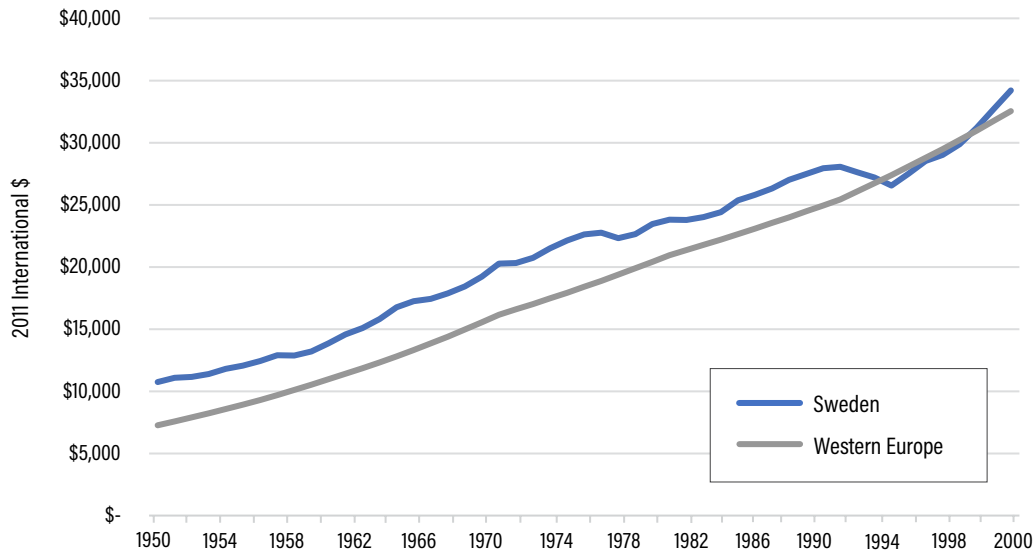


Source: Feenstra, Inklaar, and Timmer (2015).

In 1970, Sweden's per capita GDP was 25 percent higher than that of the rest of Western Europe; in 1980 it was just 14 percent higher.<sup>1</sup> And as Figure 2.5 shows, for a brief moment in the midst of the crisis in the early 1990s, Sweden's per capita income was below the Western European average. The fourth richest country on the planet was suddenly just the 10<sup>th</sup> richest (Öljemark, 2022b; Groningen Growth and Development Centre, 2022; Bolt and van Zanden, 2020).

This was not a golden era, as some outside observers would now have it. In fact, it was more like Sweden's *Atlas Shrugged* moment.<sup>2</sup> Many of the country's most important

Figure 2.5: Real GDP Per Capita (1950–2000)



Sources: Groningen Growth and Development Centre (2022); Bolt and van Zanden (2020).

Note: GDP per capita adjusted for inflation and price differences between countries.

companies, entrepreneurs, and individualists left the country, primarily because taxation was suffocating and often made it impossible to pass family companies on to the next generation.

In 1973, the founder of the furniture giant IKEA, Ingvar Kamprad, left Sweden, and the foundation that owned the company was moved to the Netherlands. Tetra Pak moved its headquarters to Switzerland in 1981 and Fredrik Lundberg, one of Sweden's richest entrepreneurs and investors, left the country in 1985. Sweden became one of the most equal countries on the planet partly because many wealthy Swedes left and set up shop elsewhere.

The two greatest Swedish sports stars of the era, tennis player Björn Borg and alpine skier Ingemar Stenmark, moved to Monaco to escape taxes. In 1976, Sweden's most famous film director, Ingmar Bergman, was arrested for tax evasion during rehearsals for a play at the Royal Dramatic Theatre. The charges were dropped, but Bergman suffered a nervous breakdown, left for Germany shortly thereafter, and swore never to make another film in Sweden. In that same year, Astrid Lindgren, the author of Pippi Longstocking and other beloved children's books, wrote an article about how she had been forced to pay taxes in a single year at 102 percent of her income, effectively causing her to lose money for every krona she earned.

Sweden did become more equal during this period. The income Gini coefficient declined from 0.26 in 1967 to around 0.2–0.23 in the 1980s. This was probably one of the lowest levels of inequality in the world and many outside observers still hail it as a success story.



However, as economists Anders Björklund and Daniel Waldenström argue in a recent paper, this is hardly relevant for present inequality debates since the reason inequality was so low was that the Swedish economy had become dysfunctional. Sweden did not increase equality by raising the bottom, but by destroying incentives to work and save through high taxes and inflation. Sweden chased high-income earners away, and few replaced them (Björklund and Waldenström, 2022).

In fact, for the first time since the Industrial Revolution, Swedes were becoming worse off financially for a sustained period. Nominal wages grew, but because of rapid inflation, real wages declined between 1975 and 1985. In 1995, the average real wage had been stagnant for two decades (Ekonomifakta, 2023a).

The summer of 1980—the year in which Paul Krugman felt Swedish society was at its ideal best—Swedes occupied themselves by reading a long-running series of articles by public intellectuals from both the left and the right on the arts pages of various newspapers warning that the Swedish experiment with socialism had degenerated into a semi-totalitarian state that undermined rule of law, civil society, and free enterprise, and chased businesses and talent out of the country.

As Figure 2.4 showed, productivity growth was slower in the 1970s and 1980s than it had been in the 1960s. But even more problematic was the effect the changes had on some of the cultural traits that Swedes took pride in. An historically strong work ethic and a reluctance to accept public benefits created a wealthy society that, in turn, made it possible to finance a big welfare state through very high taxes. But as Margaret Thatcher famously said, sooner or later you run out of other people’s money. And sooner or later, you undermine behaviour if you financially punish it enough.

In the early 1980s, 82 percent of Swedes said it was never justifiable to claim government benefits to which you are not entitled. Thirty years later just 55 percent agreed with that statement (Sanandaji, 2015: 75). After generous sick leave benefits were implemented, Swedes who were objectively healthier than any other population on the planet were suddenly “off sick” from work more than almost any other population. As early as 1978, one of the founding fathers of Sweden’s welfare state, the economist Gunnar Myrdal, complained that the traditionally honest Swedes were obsessed with escaping tax, and were turning into “a population of cheats” (Myrdal, 1978).

### The Crisis (1990-1994)

*A spiral of deficits, devaluations, and inflation collapsed Sweden’s economy leading to a major financial crisis. The country endured three years of negative growth and, for a short period, a 500 percent interest rate.*

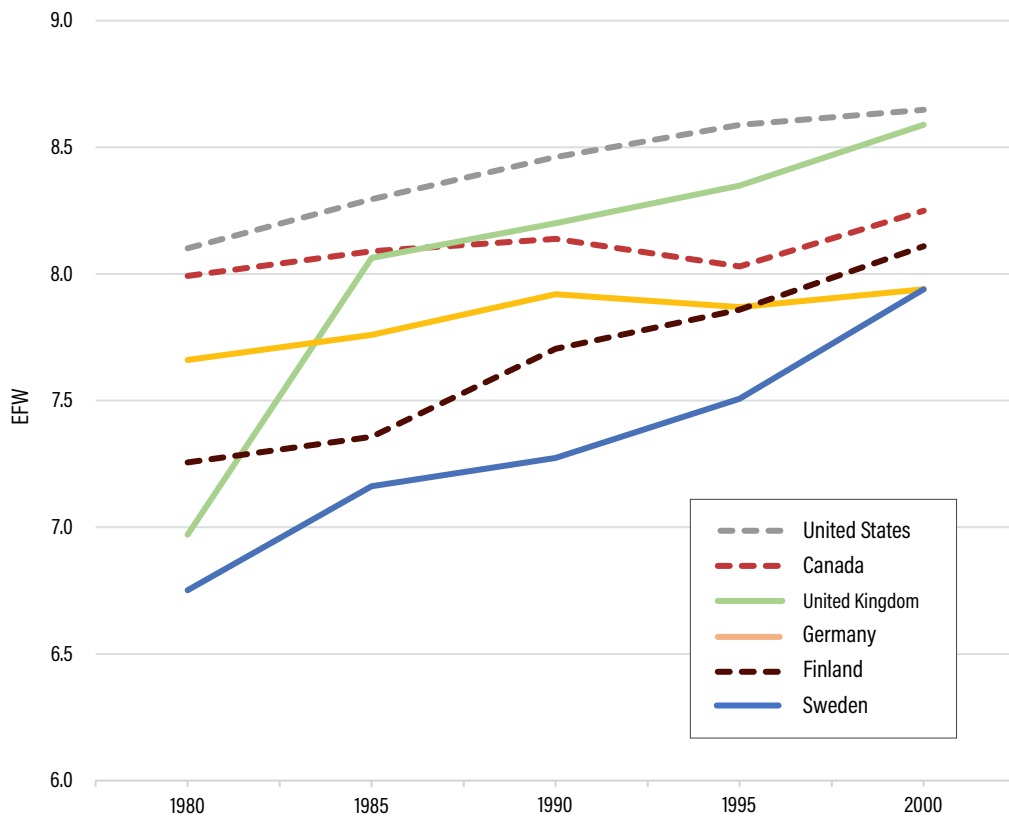
When times seemed most desperate and when many had convinced themselves that Sweden could not be reformed, the country’s political establishment again surprised outsiders by rejecting the socialist experiment, and started working hard to return to the economic

model that had been so successful in the past. Between 1980 and 2000, Sweden climbed almost 1.2 points on the 10-point Economic Freedom of the World Index scale. That improvement compares to less than a 0.4 rise for the Reaganite United States and 1.4 for Thatcherite Britain (Gwartney, Lawson, Hall, and Murphy, 2021). Figure 2.6 shows economic freedom in Sweden and five comparator nations. This was a period in which many countries were liberalizing. But Sweden’s efforts were especially pronounced and enabled it to begin to catch up with the other Western capitalist nations.

There were three reasons for Sweden undertaking the wave of reforms. First, there was widespread discontent among the general population with the government’s encroachment on their liberties. Public intellectuals, including many on the left, began to question the economic and social cost of big government. A strong opposition to an ever-growing state had started to emerge as a result of the international tide moving towards free-market ideas, but also as a result of a business-led campaign against socialism that had been started as a reaction against the Employee Funds.

A multi-year series of public reports examining democracy and power that had been initiated by the social democratic government (*Maktutredningen*) raised several issues about the powerlessness of individuals. The reports showed that Swedes paradoxically

Figure 2.6: Economic Freedom (1980-2000)



Source: Gwartney, Lawson, Hall, and Murphy, (2022).

felt less in control in the areas that they were in charge of collectively than in areas largely characterized by private-sector markets.

The public sector is largely structured according to the principle of standardized solutions. The surveys show that many who come into contact with the public sector feel powerless in silence. Areas such as education and health care are characterized by a lack of choice. (SOU, 1990: 404)

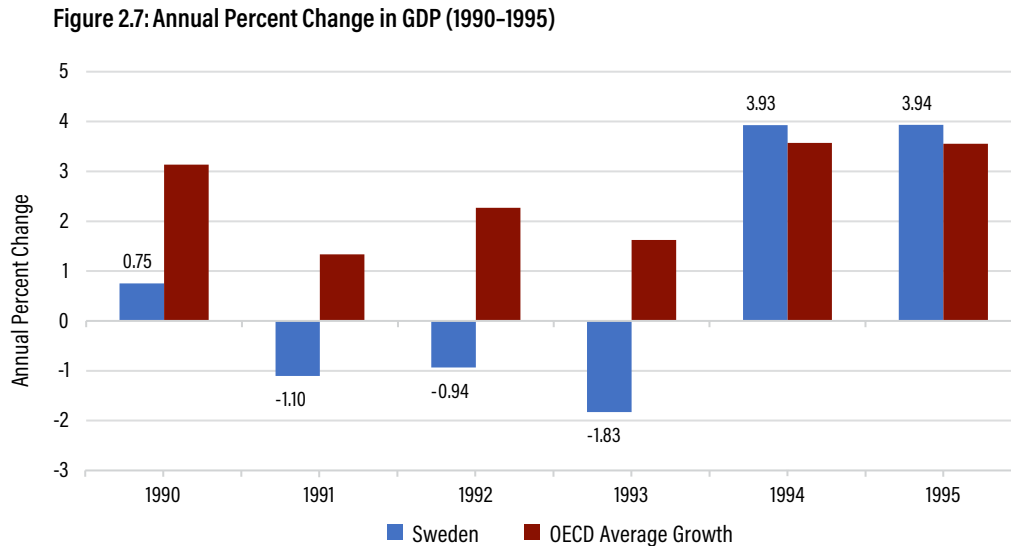
These findings had a profound effect on the social democrats who began to discuss ways of making the public sector more accountable and giving citizens more choice. Ideals of autonomy and self-reliance from the early independent cooperative and labour movement were suddenly on the agenda again.

Second, its economic model was in trouble. Sweden lagged behind other countries and suffered from a lack of entrepreneurial dynamism. By 1995, not a single net job had been created in the private sector for almost half a century. Of Sweden's 50 biggest companies in 1995, the only three that had been founded since 1970 were controlled by the national government or the city of Stockholm. A large number of the biggest companies were 100 years old and had been founded during Sweden's *laissez-faire* period (Jakobsson, 2007).

In the social democratic party a group of reformers in the department of finance came to the conclusion that the only way to save the welfare state was to implement some aspects of economic liberalization. Nicknamed "the Chancellery Office Right," they initiated some deregulation in the domestic aviation and taxi markets, lifted controls on bank lending in 1985, and removed foreign exchange controls in 1989. They also deregulated farming and replaced quasi price controls with market forces. In 1990, the government and the opposition liberal party started a major revision of the tax system, moving towards a flatter tax system with fewer loopholes for individuals and companies. In October 1990, the government decided it was time for Sweden to join the European Union so it could benefit from a common European market (after having ruled out the idea publicly just months earlier). In other words, reforms had begun before the financial crisis of the early 1990s and had been initiated by social democratic governments.

But then came the third reason, the 1990-94 financial crisis (see Figure 2.7). The crisis was deep and devastating—the country endured three years of negative growth—that ended once and for all the wishful thinking about a unique Swedish approach, a Swedish *Sonderweg*. The 1990-94 financial crisis created a political consensus that substantial reforms had to be made. Those reforms included reducing spending and liberalizing markets so the country could regain its stability and start growing again.

The 1990-94 crisis was a consequence of long-running problems of productivity and competitiveness that had never been solved. Instead, they had been kicked down the road in a spiral of deficits, devaluations, wage increases, and inflation. The government had promised that the 1982 episode was "the last devaluation," and since then it had

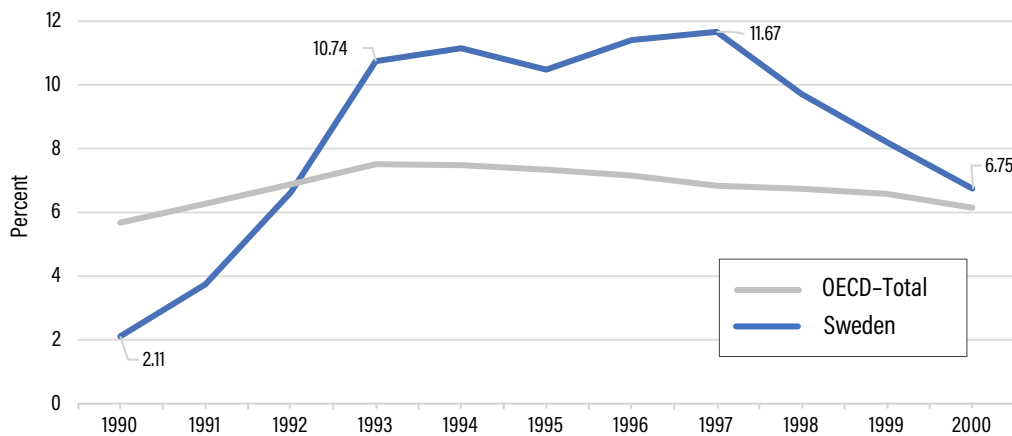


been groping around in a search for other ways of dealing with rising domestic costs. But instead of compensating for those rising costs with a more restrictive fiscal policy, the government continued to expand social programs. Since the inflationary boom raised tax revenues, the government could even present a budget surplus in 1988, which was taken as a sign that all was well and that it could keep spending.

The severity of the 1990-94 crisis also had more specific causes. The reforms of the 1980s were disjointed and ill-timed. For political reasons, it was much easier to open the credit taps than to change the tax system, so the former came five years earlier than the latter. When the minister of finance, Kjell-Olof Feldt, wanted to abolish credit controls in 1985, prime minister Olof Palme famously said, “Do whatever you want. I don’t understand anything anyway” (Feldt, 1991: 260). This deregulation unleashed a lot of liquidity in an economy that still had a grossly distorted incentive structure: The central bank held onto a loose monetary policy which, in combination with high inflation, turned interest rates negative. Before the tax reform of 1990-91, high marginal tax rates made deductions for interest rate payments even more lucrative, encouraging indebtedness and speculation. Currency controls kept most of the credit boom within the country’s borders since Swedes were legally constrained from investing outside of Sweden. The result was a real estate bubble after 1986.

What can’t go on forever, won’t. One trigger for the resulting financial crisis was sharply higher international interest rates after German reunification and speculative attacks on Sweden’s fixed exchange rate with the European Currency Unit (ECU). In February 1990 the desperate social democratic government proposed an extraordinary “Stop package” to freeze wages and prices for two years and ban strikes and dividends. It was soundly rejected in parliament and the government resigned, only to return 11 days later without these policies. However, Feldt, the minister of finance, left politics entirely. He would

Figure 2.8: Unemployment Rate, Sweden and OECD Average (1990–2000)



Source: IMF (2022)

later go on to describe the moratorium as “theoretically unreasonable and practically impossible” (Feldt, 1991: 459).

Another trigger for the financial crisis was the 1990-91 tax reform. The return to more normal conditions and incentives turned many economic projects that had been perfectly rational under the old, inflationary system into financial time bombs. Marginal tax rates, deductions, and inflation declined, and the real interest rate jumped from 1 to 2 percent in 1991 to more than 10 percent at various times in 1992. Swedes, who had a negative savings rate of 5 percent in 1988, had started to save 8 percent of their income by 1992. The commercial and residential housing market crashed and threatened to bring the whole banking system down with it. Unemployment, shown in Figure 2.8, surged to over 10 percent and remained elevated for half a decade. The central government budget deficit reached 10.6 percent of GDP in 1993.

The immediate political priority was to stem the outflow of capital from Sweden and defend the link to the ECU. When both Finland and Britain left the fixed exchange rate in September 1992, a desperate Swedish Central Bank took the drastic step of increasing the short-term interest rate to 500 percent (yes, *five hundred* percent) for a few days. Two major crisis packages agreed by the government and opposition failed to restore confidence and on November 19, 1992, the fixed exchange rate was abandoned, and the krona depreciated by 27 percent against the ECU. Once and for all the idea of controlling the value of the currency was abandoned, and the central bank instead established a goal of keeping inflation around 2 percent.

### The capitalist welfare state (1995–)

*A new reform period with economic liberalization, lower taxes, and privatization establishes a new Swedish model, which combines a large welfare state with a more open and deregulated market economy.*

“A failure must be described as a failure” commented prime minister Carl Bildt (who had taken over in September 1991) as the fixed exchange rate collapsed. But another way of looking at this episode is that it marked the death of a failed two-decade-long experiment and the birth of a new Swedish model, one that combines a generous welfare state with an open and competitive free market. It is a “capitalist welfare state” as the economist Andreas Bergh (2016) has called it.

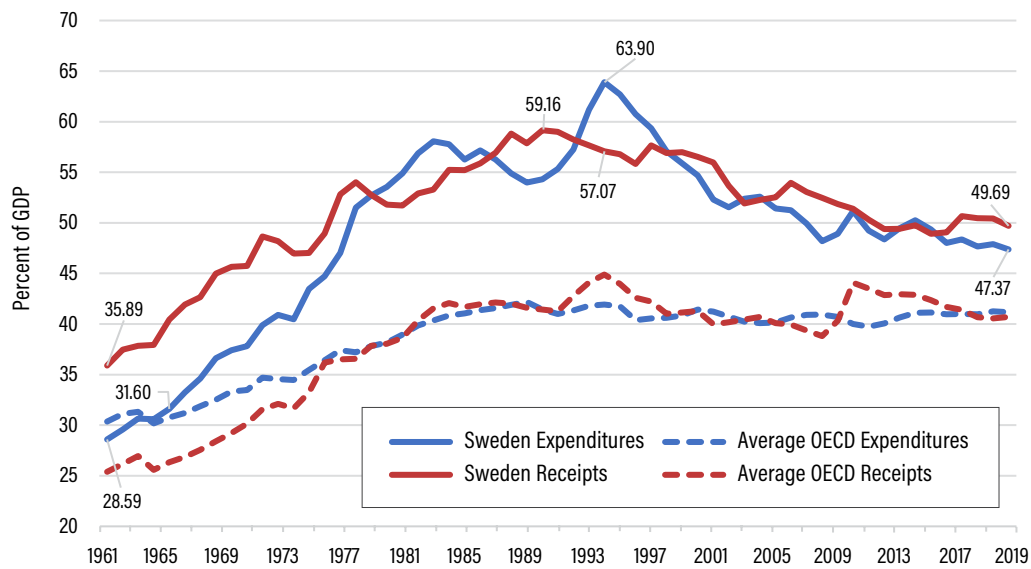
Often a financial crisis results in nothing more than fiscal austerity. In Sweden in the 1990s, however, it was met with an ambitious program of structural reforms of the economy, the government, and the public sector. One reason that the ambitious program worked was that the four-party, center-right government under Carl Bildt was reform-oriented and determined not to repeat the mistakes of the 1976-1982 governments, specifically, of administering social democracy and allowing economic stagnation to take hold. Several ministers and their advisors were steeped in liberal thought and inspired by economists like Milton Friedman and Friedrich Hayek.

Another reason that the program worked was that the reforms had been carefully prepared in advance, including through public commissions, in anticipation of potential legislation. Many of the reforms had been initiated or published under previous governments. This meant both that ideas could be turned into policy proposals quickly, and that there was the potential for political consensus. The reports of the public commissions have been compared to early warning systems, pointing out challenges ahead and thereby creating a common way of perceiving the problems that will arise and the changes needed to address them (Bergh and Erlingsson, 2009).

In November 1992, the Bildt government gave Assar Lindbeck, a leading social democratic economist (until he fell out with the party over the Employee Funds), the task of leading a commission to get Sweden out of the crisis. In just three months the commission came up with 113 proposals to improve the political process and make the economy more competitive. Many of the proposals had been suggested in previous public reports, but Lindbeck’s recommendation gave them an extra sense of urgency. Lindbeck’s report was very popular among some groups and very controversial among others, so it sparked fierce debate. In the end, though, many of its proposals became reality.

As Figure 2.9 shows, during the next few years, Sweden cut public spending substantially, moving both expenditures and revenue closer to the OECD average. The country also reduced the benefit levels in its social security systems. Nineteen state-owned companies were privatized and public investment funds that had interfered with the investment decisions of private businesses were abolished. Private and commercial radio and television stations were permitted for the first time. Railways, buses, and domestic aviation were deregulated. The telecom and energy sectors were opened up to competition. Private employment agencies were permitted, and unemployment benefits reduced. The last vestiges of the price control system were abolished, with the infamous exception of rent control, which has continued to make it very difficult to get a rental apartment in

Figure 2.9: General Government Spending and Receipts as a Share of GDP (1961-2019)



Sources: OECD (2021c); and OECD (2021d).

growing cities like Stockholm. The central bank was given an explicit inflation target of 2 percent annually.

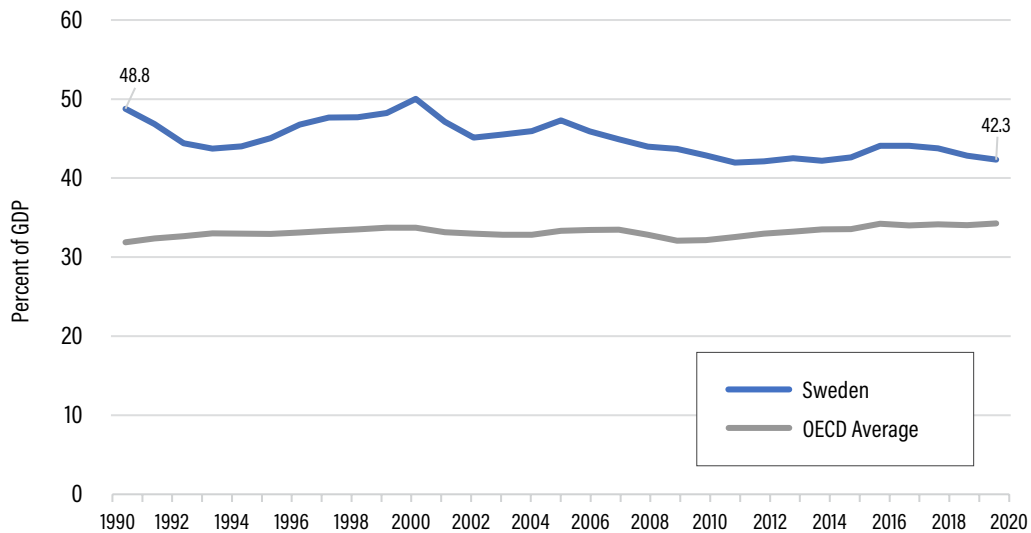
In 1992, Sweden initiated an ambitious opening up of public services when it created a national school voucher system, which gave families the freedom to choose independent schools for their children's education. Private alternatives in government-subsidized child-care, elderly care, and health care started to proliferate. Municipalities were given greater freedom to organize themselves and experiment with new forms of management and roles for private providers. Government funds for municipalities earmarked for specific uses were replaced with more general funds.

In 1994, parliament decided to introduce a new pension system, which replaced defined benefits with defined contributions and included a "break" that automatically reduces payments in bad times. It also included individual accounts, which can be invested according to personal preference. In 1995, Sweden joined the EU and got access to the internal market and freedom of movement across the continent, even though, paradoxically, to conform to EU regulations Sweden also had to re-introduce regulations, subsidies, and tariffs in the agricultural sector, which had just been abolished.

Some of the reforms of the 1990s aimed to make the political process more sustainable and less prone to short-termism. The parliamentary term of office was extended from three to four years to avoid governments operating in perpetual campaign mode. In 1997, the government introduced a new budget process that set a limit for total spending in advance. Any later increase in spending in one area had to be financed within the budget and taken from some other area.

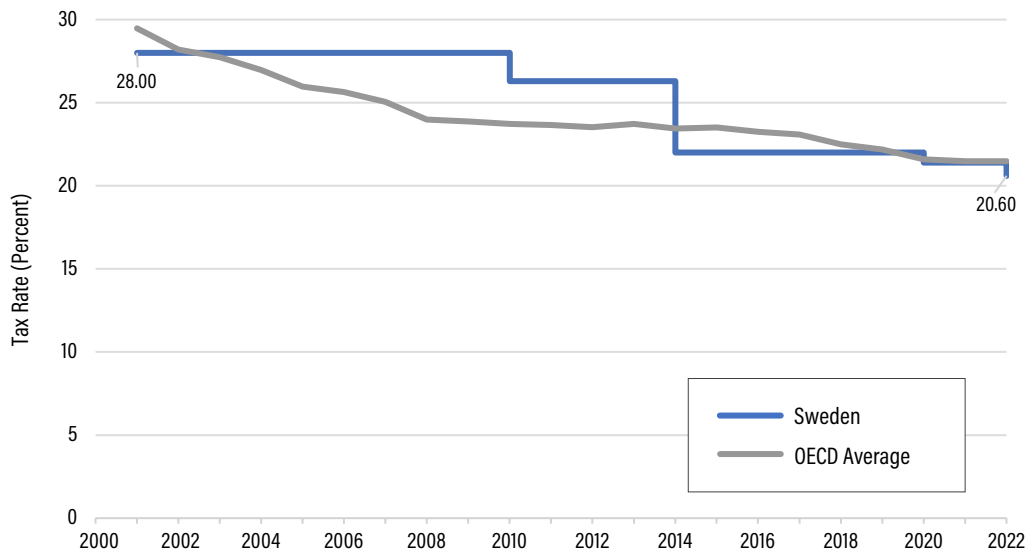
The 1990s marked another great reform for Sweden after which the country was in many ways more open and less regulated than other countries. Sweden still has a large government, but it is much less of an outlier than it was. Public social spending is 25.5 percent of GDP, just the 8<sup>th</sup> highest in Europe and far below France’s 31 percent (OECD, Undated a). As Figure 2.10 shows, total tax revenue as a percentage of GDP declined from almost 50 percent in 1990 to around 42 percent in 2020. The corporate tax rate, shown in Figure 2.11, which had been far above 50 percent in the 1980s has been repeatedly

**Figure 2.10: Tax Revenue as a Percent of GDP (1990-2020)**



Source: OECD (2021a).

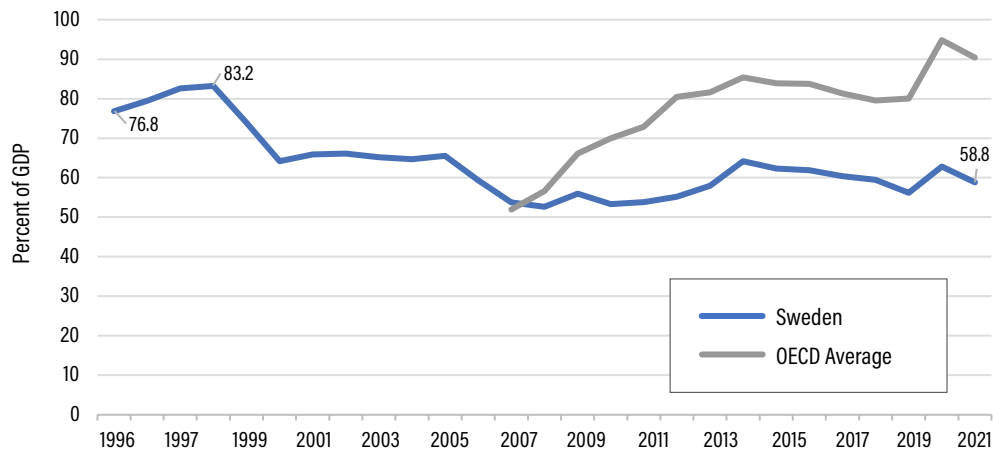
**Figure 2.11: Corporate Income Tax Rate (2000-2022)**



Source: OECD (Undated b).



Figure 2.12: General Government Debt as a Share of GDP (1995–2021)



Source: OECD (2021b).

lowered and is today 20.6 percent. Capital gains used to be taxed as personal income and therefore at a progressive rate. They are now taxed at a proportional rate, between 15 to 30 percent, depending on the sort of capital. Taxes on wealth, gifts, and inheritance have been abolished. And yet, as shown in Figure 2.12, Sweden's public debt has come down from a peak of 83.2 percent of GDP in 1998 to 58.8 percent in 2021.

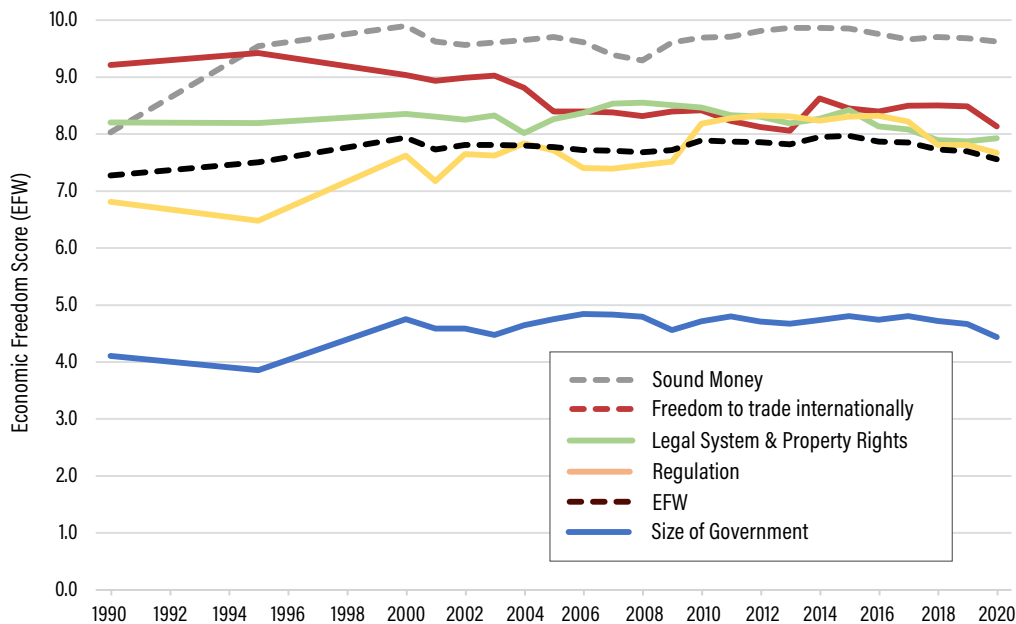
Since 1995 the Swedish economy has once again begun to outperform that of other high-income countries in growth per capita, and has once again begun to spawn successful international companies including Skype, Spotify, King, Mojang, and Klarna. Real wages, which were stagnant between 1975 and 1995, increased by around 70 percent between 1995 and 2021 (Ekonomifakta, 2023a).

In the Global Competitiveness Index of 2019 Sweden is ranked as the world's 8<sup>th</sup> most competitive economy (4<sup>th</sup> in Europe). In the macroeconomic category, it got a perfect score of 100.

However, Sweden is still a big welfare state; total public spending is around 50 percent of GDP, as shown in Figure 2.9. The country's economic comeback after 1995 challenges the idea that big government will always hurt an economy. One explanation for Sweden bucking that trend is that it compensates with a more open and deregulated economy in other ways. Figure 2.13 demonstrates this. It shows overall economic freedom and its five constituent components from 1990 through 2020. While Sweden continues to score low on the size of government component of economic freedom, it scores highly on all other measured components of economic freedom. Compared with citizens of most other countries, Swedes enjoy high levels of regulatory freedom, freedom to trade internationally, sound money, and legal protection of their persons and property.

In the World Bank's Ease of Doing Business Index 2020, Sweden is ranked as the 10<sup>th</sup> easiest country in which to do business out of 190 countries (5<sup>th</sup> in Europe), which is a

Figure 2.13: Economic Freedom and Its Components in Sweden (1990–2020)



Source: Gwartney, Lawson, Hall, and Murphy (2022).

remarkable turnaround for a country where doing business was seen as hopeless in the 1980s, forcing many of the most successful companies to leave the country. In the Economic Freedom of the World Index, Sweden has more economic freedom than the United States in three out of the five areas.

In the 1990s, Sweden also gave up the pipe dream of making the wealthy pay for it all. Swedes learned that you could either have a big government *or* make the rich pay for it all, but you couldn't have both. High earners and successful businesses are too few and too important for the country's economy to deter or chase away with high taxes. Scaring off high earners and successful businesses had not just hurt innovation and risk-taking, it had also threatened the long-term financial basis for the welfare state. Now Sweden relies more on consumption taxes and flat payroll and local income taxes that it did before the reforms, which means that most citizens pay for most public services out of their own pockets and that the country is once again a more attractive place to do business (more on this in the next chapter).

Furthermore, not all big governments are created equal, and a major difference between them is how much knowledge is needed for government intervention to succeed. Some interventions, like Keynesian stabilization policies, targeted industrial policy and subsidies and protections for particular sectors, require a lot of centralized knowledge to function, and so are more prone to failure. On the other hand, there are other programs that are less dependent on superior centralized knowledge, like automatic cash handouts and welfare systems where individuals chose providers and pension systems with no defined benefits, and where individuals chose their own retirement age and where benefits are adjusted

accordingly. Andreas Bergh has coined the phrase “Hayekian welfare states” for projects that do not rely on much centralized knowledge, and since the 1990s, the Swedish welfare state has moved substantially in that direction.

The 1970s and 1980s increasingly look like an aberration in Swedish history, both in terms of policy and economic outcomes. Sweden, which had been an open capitalist economy during the miraculous century between 1870 and 1970 then moved in a decidedly socialist direction by increasing the size of government, regulations, and taxes. The result was a 20-year period that hurt the economy’s competitiveness and citizens’ living standards, and that ended in the terrible financial crash of the early 1990s. Then came a sharp retreat from socialist policies and the country implemented reforms that once again moved Sweden back to a broadly successful, capitalist-inclined economy.

As Kjell-Olof Feldt, the social democratic minister of finance from 1982 to 1990, summarized Sweden’s late 20<sup>th</sup> century experience: “What we believed in as young socialists turned out to be impossible in practice” (Josefsson, 2006: part 6 of 7).

### Notes

- 1 GDP per capita has been adjusted here for inflation and price differences between countries.
- 2 In Ayn Rand’s 1957 novel *Atlas Shrugged*, talented and hard working individuals leave an increasingly authoritarian society.

## THE EVOLUTION OF SWEDEN'S FISCAL POLICY

The story of Sweden's modern fiscal history is the story of how a country that at one time held a worldwide record for high taxes and government spending and with unsustainable debt levels turned itself into a fairly normal European country, with fiscal rules and debt levels that are in many ways exemplary.

From the 1970s until the financial crisis of the early 1990s the Swedish government expanded rapidly, and during that time its spending reached unprecedented levels. Sweden's total government spending increased from 31.6 percent of GDP in 1965 to a peak of 63.9 percent in 1993 (see Figure 2.9 above). However, this resulted in economic underperformance and the deep economic crisis of the early 1990s. Sweden learned its lesson and made a complete policy turn-around, and has since been a world leader in downsizing government. By 2022, government spending had been reduced to 49.6 percent of GDP, despite an increase in spending during the pandemic. This is a reduction of more than 14 percentage points—an impressive achievement. Even though spending is still higher than the OECD average, it is now at a fairly typical European level, and six OECD countries have higher government spending relative to GDP (OECD, 2021d).

Taxes were also cut after the fiscal crisis (again, see Figure 2.9). Total tax revenues as a share of GDP have come down from almost 60 percent in the late 1980s to less than 50 percent in 2019, halving the difference with the OECD average from 18 percentage points in 1990 to 9 percentage points in 2019.

Sweden's total government debt, shown earlier in Figure 2.12, has been reduced from 83.2 percent of GDP in 1998 to 58.8 percent in 2021 despite the global financial crisis and pandemic spending (OECD, 2021b).

A new set of fiscal rules implemented in the second half of the 1990s was instrumental in introducing fiscal discipline after the financial crisis. The government must set a ceiling for government spending three years in advance and must aim for a goal of achieving a surplus in the national government's finances by an annual average of one third of a percent of GDP over a business cycle. Increased spending in one area has to be offset with reductions in other areas so that spending stays below the agreed-upon ceiling. Parliament must approve the budget in its entirety to avoid issue-specific deficit spending coalitions from forming. Municipalities and regions are also required to balance their budgets.

This budget process is a way for politicians to tie themselves to the mast, although since there is no constitutional protection for the budget rules, a majority of them could revoke the rules at any time. However, memories of the 1990 crisis are so strong that, at least so far, it has been difficult for any major political force to challenge it. The surplus goal has been lowered over time, but the fundamental framework has so far remained intact.

### Government spending

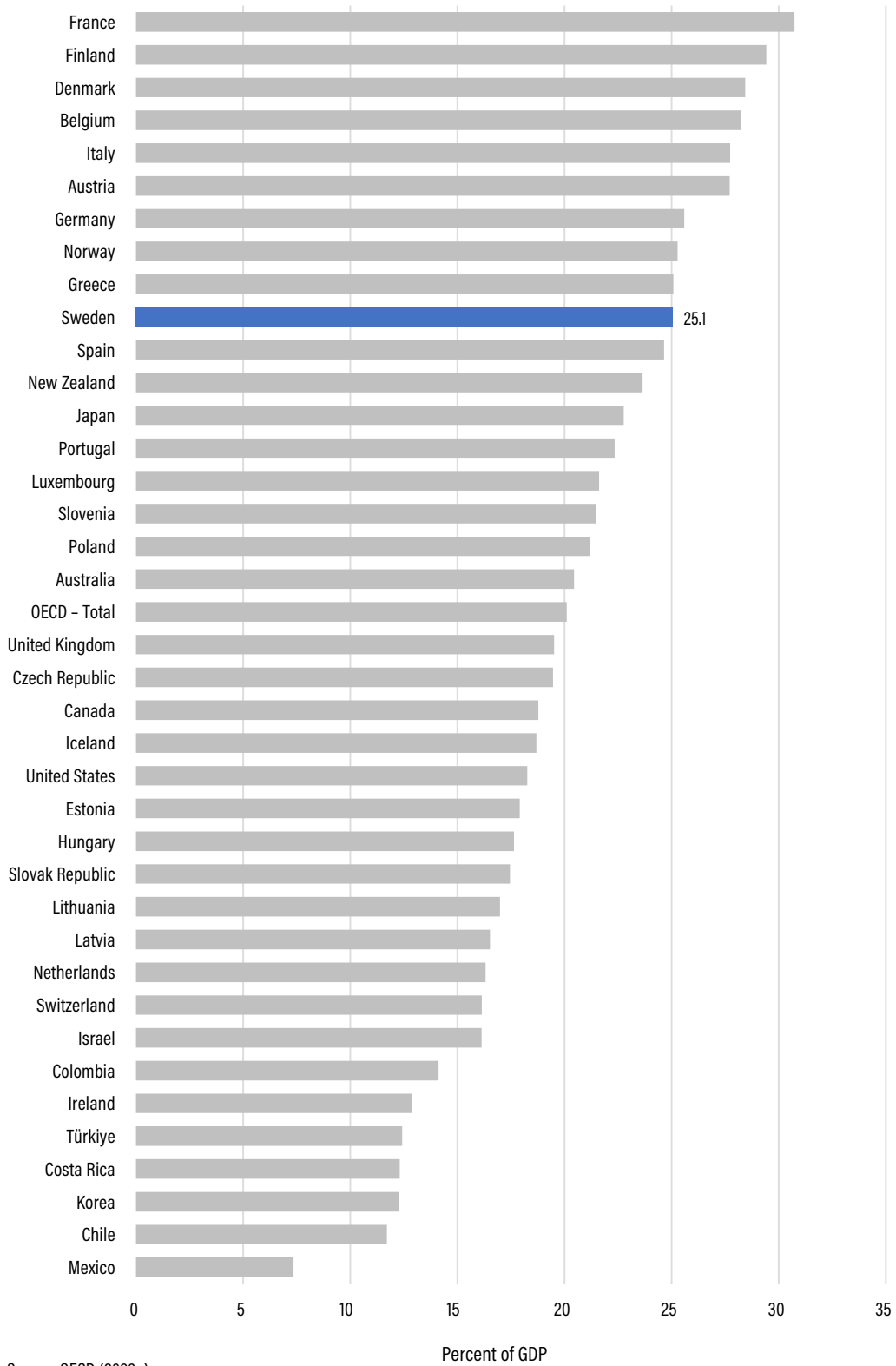
The Swedish welfare state is often understood abroad either as a Robin Hood government that takes from the rich and gives to the poor, or as a Sheriff of Nottingham government that robs all the people to waste money on inefficiencies and vanity projects. But the structure of taxation and spending suggests that a third alternative might be more accurate, a mildly paternalistic government that withholds much of the citizens' income through taxes and hands it back to them when the government thinks they really need it. It is neither Robin Hood nor the Sheriff of Nottingham; it's Mary Poppins (or any other nanny).

The Swedish welfare state mostly redistributes money over an individual's life cycle—Swedes pay high taxes during their work life and in return receive generous benefits before retirement when they need child care and education, and after, when they need pensions, health care, and elder care. It has been estimated that more than 80 percent of all the taxes the average Swede pays over a lifetime is handed back to that same individual (minus deadweight losses), and only 20 percent given to others (Pettersson, Westerberg, and Pettersson, 2006).

What stands out in an international context is Sweden's spending on social protection, shown in Figure 3.1 (see Table 3.1 for a more detailed breakdown). At 25.1 percent of GDP in 2019, this is higher than the OECD average of 20.1 percent, but below spending by big European countries like France (30.7 percent), Italy (27.7 percent), and Germany (25.6 percent). Of this social protection, there are two areas where Sweden spends much more than the OECD average: Family spending (3.4 vs 2.1 percent) because of child care subsidies, cash payments, and generous parental leave; and spending on incapacity (3.4 vs 2.0 percent). For other areas, such as household benefits, pensions, labour markets, and unemployment, Sweden is close to or below the OECD average (OECD, 2022b).

As shown in Figures 3.2 and 3.3, the Swedish national government spends 7.0 percent of GDP on health care and 6.9 percent on education (the OECD average is 6.5 and 5.2 percent respectively). Defense spending is at just 1.2 percent, down from around 3 percent during the Cold War. However, following Russia's invasion of Ukraine, the government's ambition is to raise the level of defense spending to 2 percent of GDP. Because of Sweden's reputation for environmental protection, it is worth mentioning that spending on this is at the OECD average of 0.5 percent of GDP and below the EU average of 0.8 percent. One reason for this incongruity is that Sweden's environmental policy is often implemented through regulations and taxes rather than spending (OECD, 2019).

Figure 3.1: Public Social Expenditures as a Percentage of Gross Domestic Product (2019)



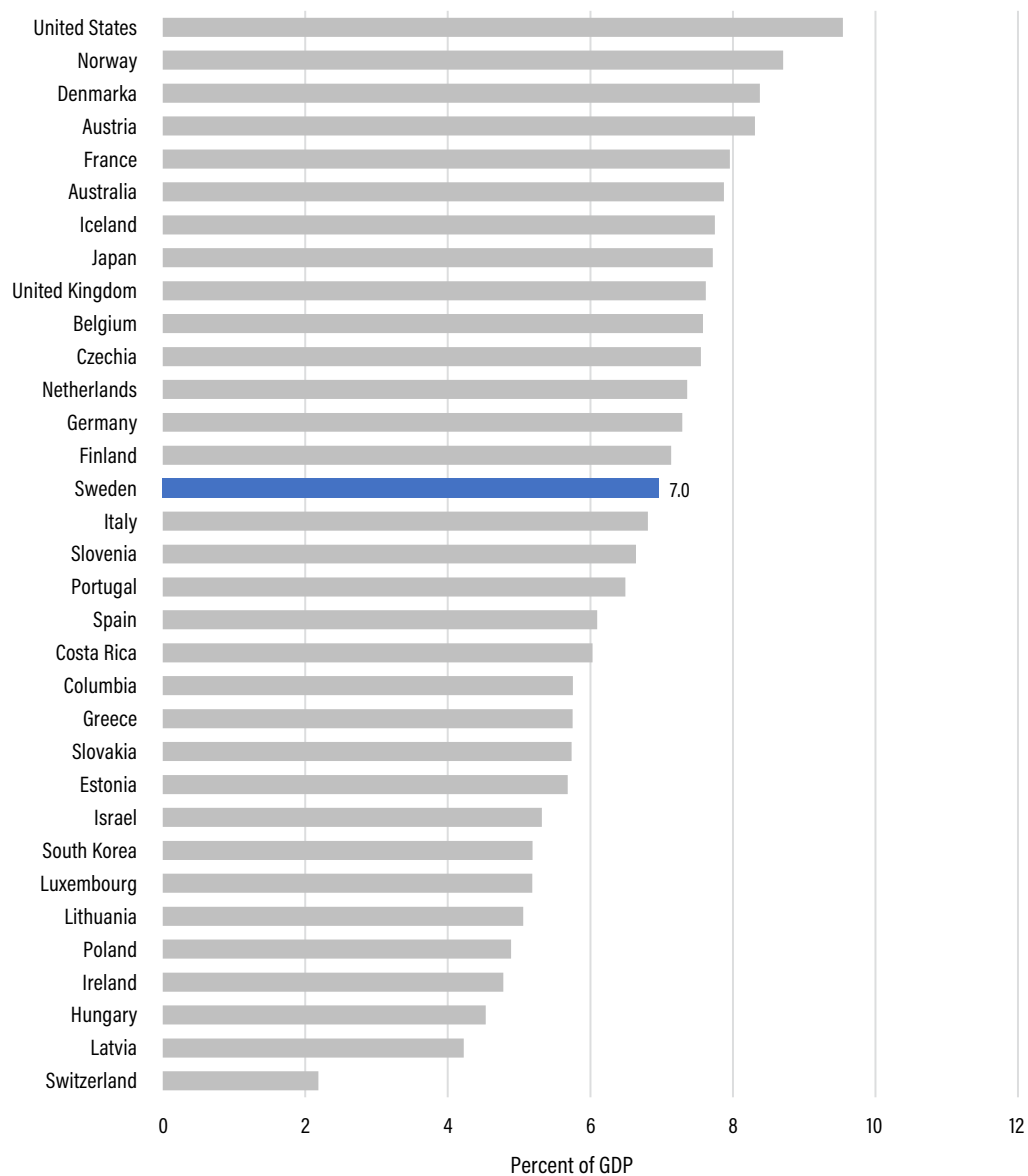
Source: OECD (2023a).

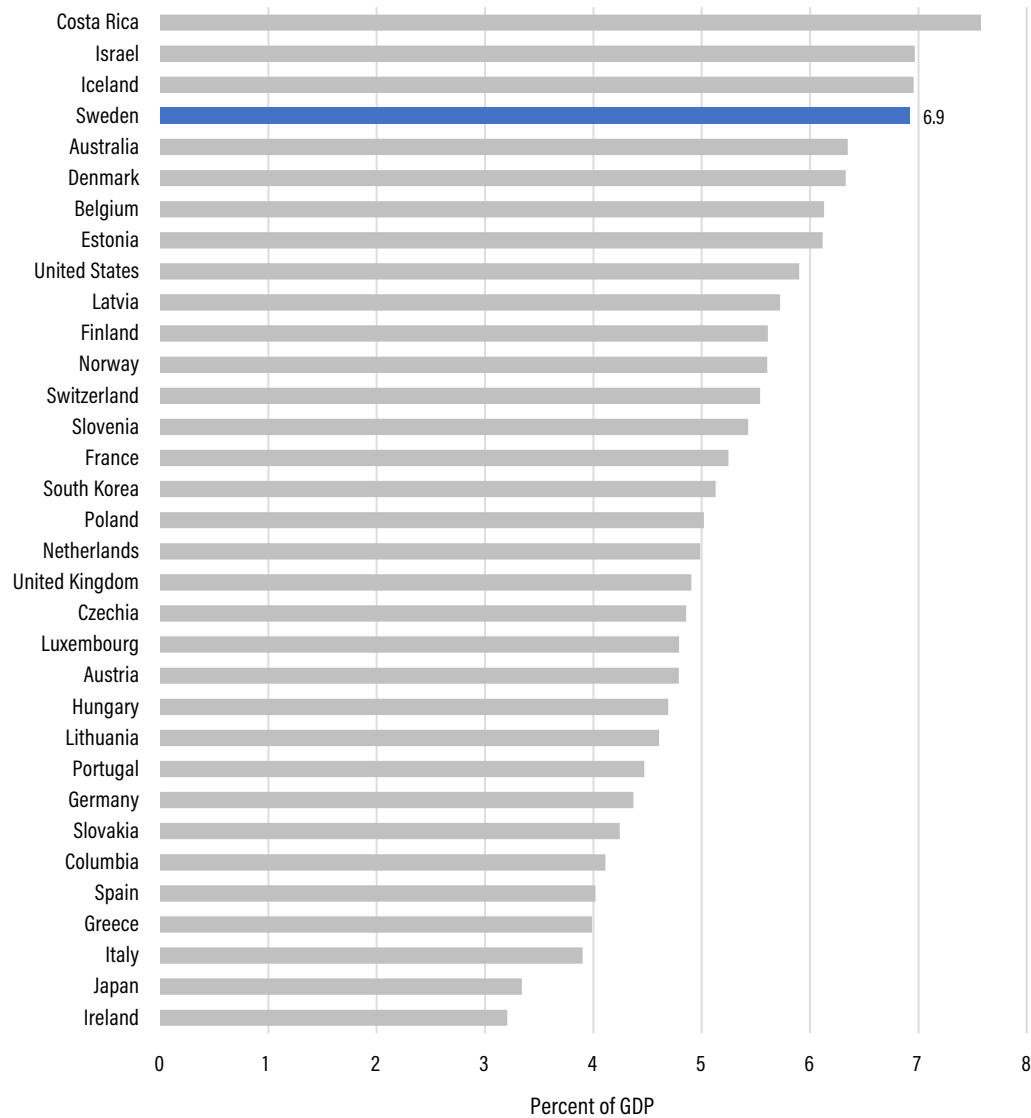
**Table 3.1: Government Spending by Function as a Share of GDP, 2019**

General public services	6.9%	Housing and community amenities	0.7%
Defence	1.2%	Health	7.0%
Public order and safety	1.3%	Recreation, culture and religion	1.3%
Economic affairs	4.4%	Education	6.9%
Environmental protection	0.5%	Social protection	19%

Source: OECD (2019).

**Figure 3.2: General Government Expenditure on Health Care as a Percent of GDP (2019)**



**Figure 3.3: General Government Expenditure on Education as a Percent of GDP (2019)**

Source: OECD (2021c).

## Taxes

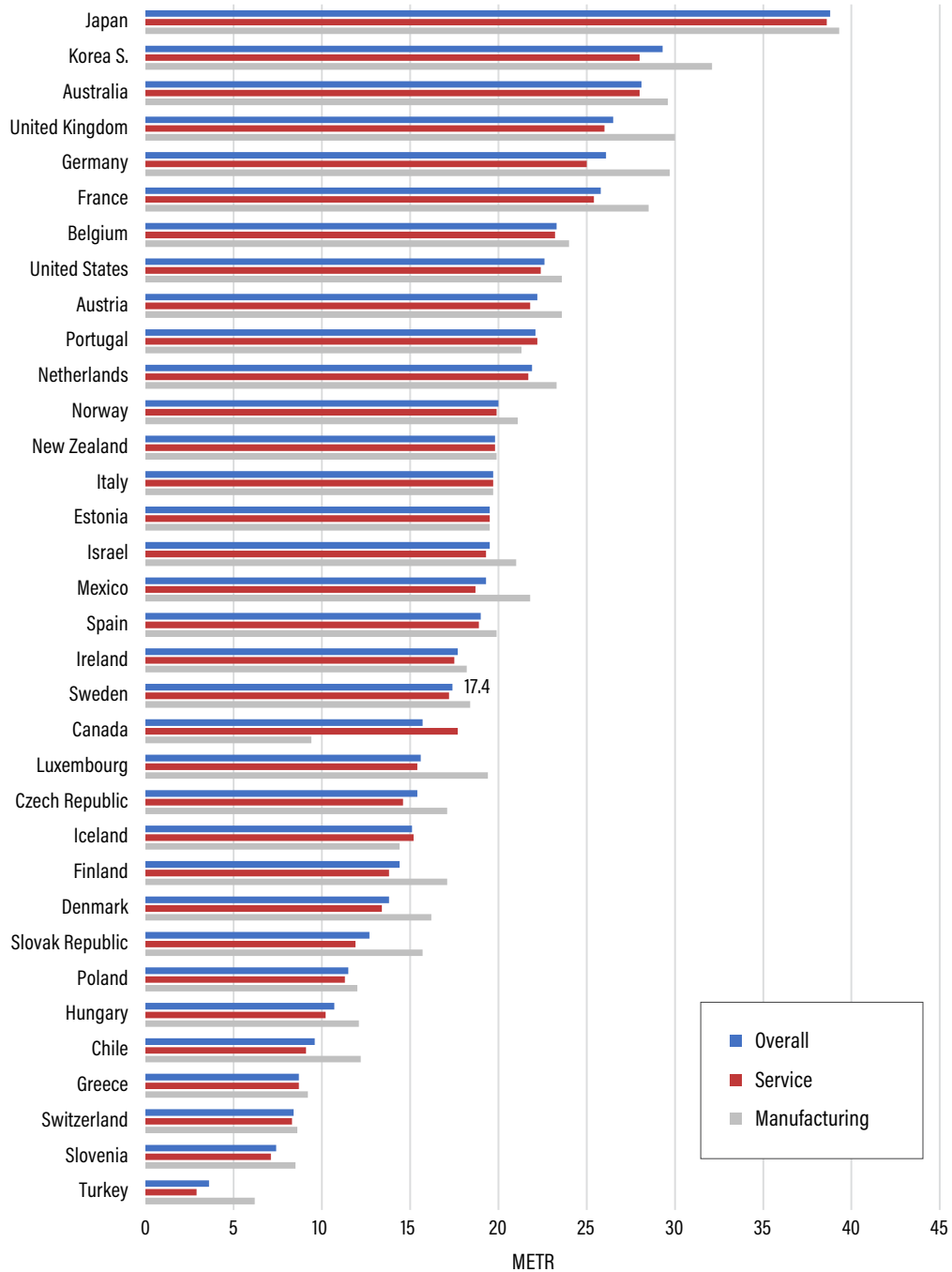
Until the turn of the millennium, Sweden had the highest taxes in the world as a share of GDP. Tax revenue as a share of GDP was around 50 percent (see Figure 2.10 above). In the late 1970s, the country's highest marginal tax rate was 90 percent, and on the average income it was around 70 percent (Bergh, 2022: 74). However, the major parties began to agree that such punitive tax rates punished education and hard work and made the Swedish economy lag behind that of other countries. Therefore, in 1991 it implemented a big tax reform that reduced taxes substantially; it aimed to ensure that 85 percent of the population would just pay local, flat income taxes around 30 percent, and the highest 15 percent of earners would pay 20 percent in federal income tax, resulting in a personal marginal income tax rate that at its highest would be around 50 percent. At the same



time, the government lowered the corporate tax rate from 52 to 30 percent. Today, as Figure 2.11 above shows, the corporate tax rate is 20.6 percent, below the OECD average of 21.4 percent.

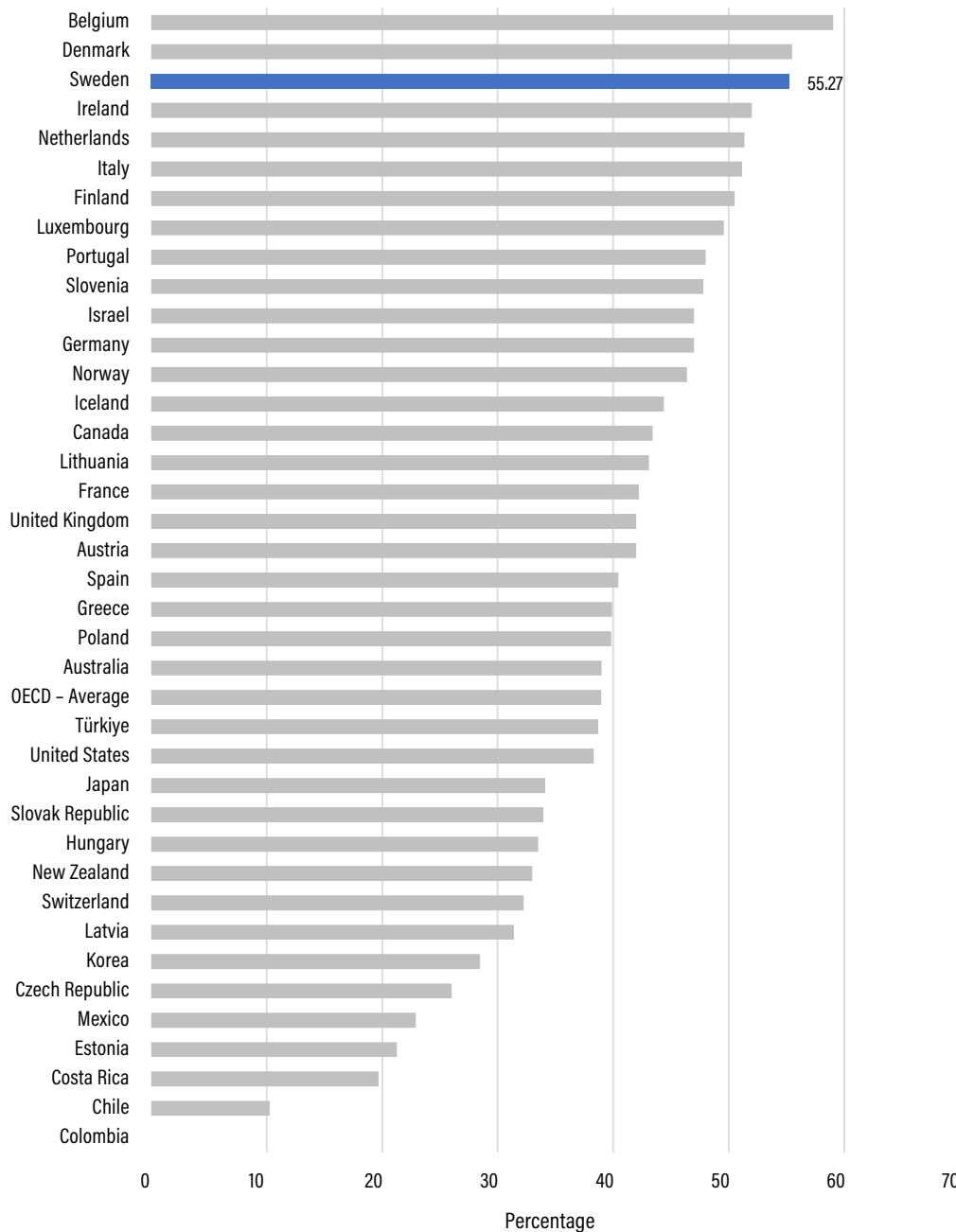
Figure 3.4 shows the corporate marginal effective tax rates (METR) for 2021 across a number of countries (Bazel and Mintz, 2022). At 17.4 percent, Sweden’s overall corporate marginal effective tax rate is 6.4 percentage points below the GDP-weighted average of

**Figure 3.4: Corporate Marginal Effective Tax Rates (2021)**



Source: Bazel and Mintz (2022).

Figure 3.5: Net Personal Marginal Tax Rate as a Percent of Gross Wage Earnings: Principal Earner (2021)



Source: OECD (Undated e).

Note: Household type is a single person at 167% of average earnings, without child.

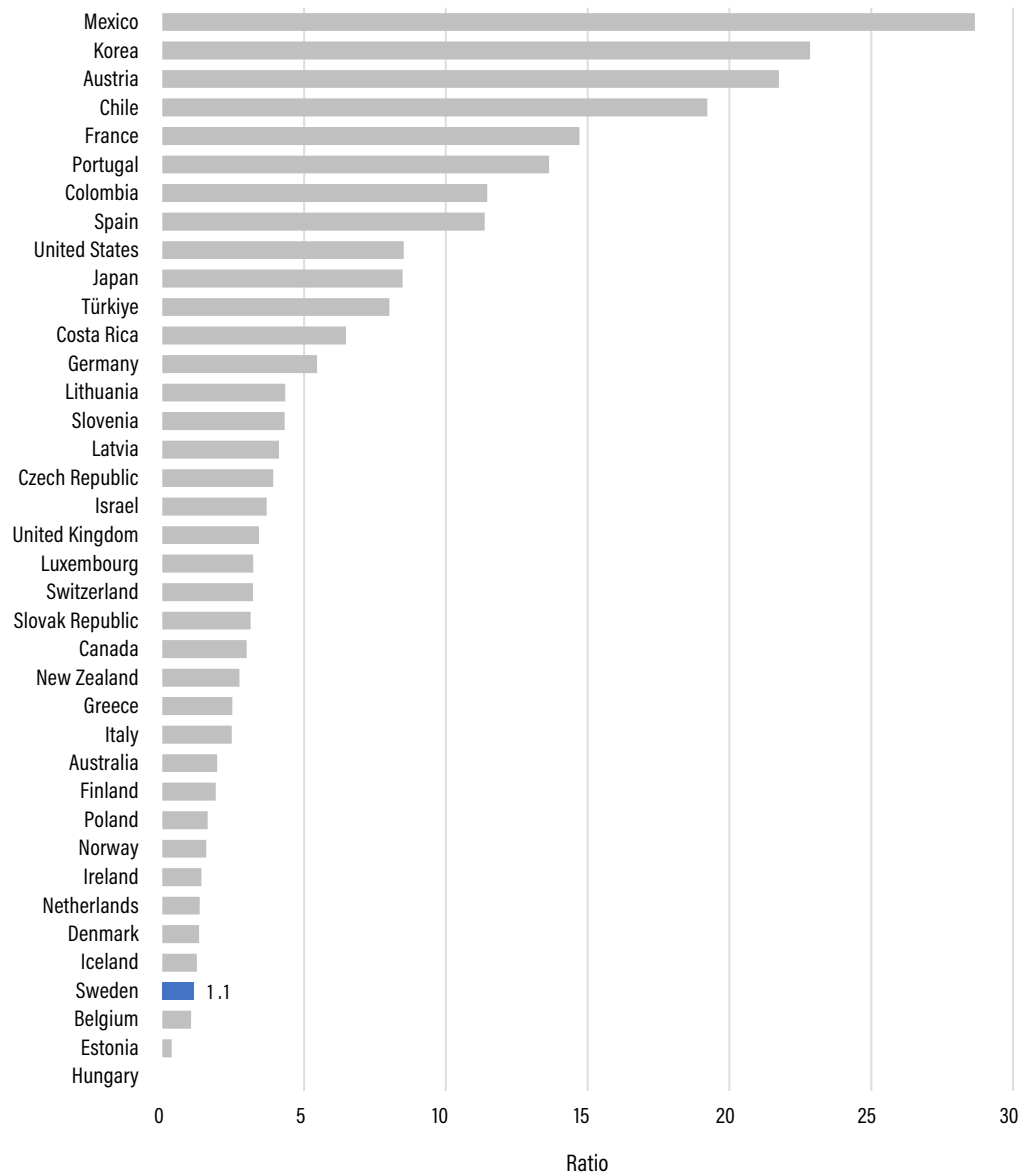
23.8 percent. Moreover, the spread between Sweden’s manufacturing METR and METR for the service sector is just 1.2 percent, indicating that the country does not discriminate significantly between sectors.

Income taxes are indexed to inflation, but capital gains taxes are not. Sweden has a high capital gains tax rate, normally 30 percent, but there are many important exceptions to

that rate. Dividends from small companies with few owners are taxed at 20 percent, and profits from sales of owner-occupied residencies are 22 percent. Since 2012, individual savers can also put their shares and funds into a special investment account that is free from capital gains taxes and is instead taxed at a special, annual lump rate, presently 1.65 percent. There is no limit on the annual or lifetime amount an individual can invest and there is no cut-off for high-income earners.

Figure 3.5 shows the top net marginal personal income tax rate for a number of countries for 2021. At 55.3 percent Sweden has the third-highest rate in the OECD. Figure 3.6, however, puts this rate in perspective. It shows the ratio of the top marginal income tax rate threshold to the average wage. The value for Sweden, 1.1, indicates that the threshold

**Figure 3.6: Ratio of Top Rate Threshold to Average Wage (2021)**



Source: OECD (2022c).

for the top marginal income tax rate is just 10 percent higher than the average wage. Only three other countries in the OECD have a lower threshold for the top marginal income tax rate. In other words, Sweden has relatively high taxes, but it also has one of the flattest rate structures in the world (see Table 3.2).

A major change since the 1980s is that taxes on asset ownership have been abolished. The first inheritance and gift taxes were instituted in 1885, though the rates remained low until the mid-twentieth century (Waldenström, 2018). By the 1980s, the effective inheritance tax rate had risen to 70 percent while the effective wealth tax rate had reached 4 percent (Waldenström, 2018). Wealth taxes often forced family-owned businesses to be broken up after a generational shift in order to pay the taxes that change triggered, and it became a strong motivation for wealthy people and businesses like IKEA and Tetra Pak to leave Sweden. Since the taxes were so destructive, they also became riddled with exceptions that made them seem unfair.

Göran Persson, the Social Democratic prime minister from 1996 to 2006, has described taxes on wealth, inheritance, and gifts as ideological taxes that never raised much revenue, but hurt Sweden's economy:

Taxes on inheritance and gifts... were paid only by those who could not afford consultants. A conscientious blue-collar or white-collar worker who worked all his life and saved his money and then sold his house and got a penny in the bank – they or their children had to pay it. The wealth tax hurt Sweden with an exodus, we lost a lot of successful entrepreneurs. It wasn't worth it.<sup>1</sup>

In 2004, a Social Democratic government supported by the post-communist party abolished the taxes on gifts and inheritances, and in 2007, a center-right government abolished the wealth tax. In 2008, the national property tax was replaced by a municipal charge of at most SEK8,524 (US\$867), regardless of the value of the property.

Since then, fortunes have returned to Sweden. In 2013, Ingvar Kamprad, the founder of IKEA, went back to Sweden. The number of rich people has increased in most countries,

**Table 3.2: Marginal Tax Rates in Sweden in 2023**

Annual income (SEK)	US dollar equivalent	Marginal tax rate
25,000	\$2,325	8%
80,000	\$7,440	19%
195,000	\$18,135	27.5%
430,000	\$39,990	32.4%
620,000	\$57,660	52.4%
720,000	\$66,960	55.5%

Source: Torstensson (2023).

but especially so in Sweden, which now has more dollar billionaires per capita than the United States and any other EU country (Ydstedt and Wollstad, 2020).

Ever since the 1991 tax reform, politicians have tinkered with income taxes. The national income tax was increased temporarily by five percentage points in 1995 as a part of the fiscal consolidation after the crisis. This was supposed to be a short-term crisis measure but it remained in place for 25 years. From 2006 to 2014 the center-right government continuously and substantially reduced taxes on income, but focused those efforts on lower and middle incomes; the stepped reductions leveled off at higher incomes. This has turned the fairly simple 1991 system into one with multiple different marginal tax rates.

Even after the tax cuts, the highest real marginal tax rate (66 percent once payroll taxes are included) is higher in Sweden than in all other OECD countries but Belgium if you include the exceptionally high payroll taxes of 31.42 percent which the employer has to pay before paying the wage but which is mostly passed on to employees.

High taxes make it costly to employ people, which has stimulated the emergence in Sweden of a large informal (or “black market”) sector for services like cleaning and repairs. As a response to the rise in informal market activity, the government initiated two systems of tax reduction for personal services in the early 2000s. Now if you hire someone to do home repairs, conversions, or extensions, you can claim a 30 percent deduction for labour costs. If you hire someone to perform cleaning, maintenance, or laundry, you can deduct 50 percent of those labour costs. Since these reforms were brought in the informal sector has shrunk.

In total, around 60 percent of Swedish tax revenue comes from direct and indirect taxes on labour (see Table 3.3). That is 10 percentage points more than the OECD average, making Swedish finances sensitive to business cycles and changes in employment levels. Slightly less than 11 percent of revenue comes from taxes on businesses and capital.

**Table 3.3: Tax Revenue, 2021 (in Swedish krona)**

Direct taxes on labour:	667.1
(national component:	49.9)
Indirect taxes on labour:	579
Taxes on corporate income:	132
Taxes on other capital:	112.7
VAT:	467.8
Excise taxes:	136.7
Tax on imports:	6.2
Taxes transferred to the EU:	(10)
<b>Total:</b>	<b>2091.5</b>

Source: Ekonomifakta (2022).

Compared to North America, Sweden's reliance on consumption taxes stands out. Twenty-two percent of Swedish tax revenue comes from a value added tax, which is set at 25 percent for most goods and services except for food (12 percent) and a few things like newspapers and books (6 percent). Meanwhile, 6.5 percent of Swedish tax revenue comes from excise taxes on goods and services like energy, carbon, vehicles, alcohol, and tobacco.

The overall structure of the tax system makes it surprisingly non-progressive. Even though such a large share of the revenue originates from taxes on labour income, only 4 percent of that comes from the progressive national income tax. Most tax revenues from labour income are from proportional local income taxes and payroll taxes.

The overall effect is that Sweden's tax system is now one of the *least* progressive in the OECD (Joumard, Pisu, and Bloch, 2012). This sounds counterintuitive, but smaller welfare states with more targeted and means-tested benefits can generally rely more on incomes from smaller groups of high-income households, while universal welfare states need more income than that. Sweden realized at great cost in the 1970s and 80s that it was dangerous to try to get the rich to pay for all government expenditures. There were too few of them, and the economy was too dependent on people and businesses who were highly mobile. Financial plans were repeatedly frustrated, and the Swedish government ran budget deficits for almost two decades, more than tripling its debt level as a share of GDP.

According to a 2008 OECD study (see Table 3.4), the richest decile in Sweden pays almost exactly the same share in household taxes as their share of market income (26.7 versus 26.6 percent), while in the OECD top 10 countries, the richest decile pays 1.11 times more in taxes than their share of market income (31.6 versus 28.4 percent), and in the US the top decile pays 1.35 times their share of market income (45.1 versus 33.5 percent) (OECD, 2008: 107).

Redistribution of income in Sweden instead comes from the spending side: public services and transfers. Housing benefits and social assistance have the largest redistributive effect. Taxes and transfers combined reduced more than 40 percent of the market inequality in Sweden in 1995, but this fell by 15 percentage points in the two ensuing decades down to a level close to that of Australia and Britain. This was partly as a result of tax reform, but also less generous government benefits (Causa and Hermansen, 2019).

**Table 3.4: Tax Ratio for Richest Decile in Selected Countries, 2008**

Country	Tax ratio	Country	Tax ratio
Sweden	1.00	Germany	1.07
France	1.10	Italy	1.18
United Kingdom	1.20	Canada	1.22
Australia	1.29	United States	1.35

Source: OECD, 2008: 107.

## Debts and deficits

After the 1990s financial crisis, Sweden suffered government budget deficits only during the dot-com crash of 2000-2001, the global financial crisis of 2008-2009, and the pandemic. It has made up for those deficit years by posting bigger surpluses in good times. The average for the two decades from 2000 to 2022 is an annual budget surplus of 0.3 percent of GDP. This is much better than most OECD countries and is a result of relatively high economic growth and the new fiscal framework (OECD, 2022d).

Fiscal surpluses have made it possible for Sweden to reduce its government debt during a period in which most other OECD countries have amassed more debt than ever. Sweden's national government debt was 76.8 percent of GDP in 1995. Then the country undertook its ambitious effort to reduce deficits and debts, including a fiscal consolidation whereby government spending was reduced by a dramatic 10 percent of GDP between 1994 and 2000 under a social democratic government. This reduction was achieved primarily through cuts in social benefits, housing subsidies, and support for municipal and regional services. By 2021, public debt had declined to 58.8 percent of GDP, despite the country running budget deficits during the pandemic. The OECD average was 94 percent of GDP in 2020 (OECD, 2021a).

Unusually for a rich country, the Swedish pension system is not very sensitive to an aging population. After a major reform that was fully implemented in 2003, the public pension system is now best described as a defined contribution system. Income and expenses are governed by a fixed set of rules and are not part of the government budget. As benefits depend on future economic growth, wage increases, and returns on investments—and are subject to reductions in bad times—the government does not have the same liabilities as countries that have defined benefit systems.

This does not mean that the government is not sensitive to demographic changes. Because the country depends on labour income taxes and spends generously on health care and elder care, an aging population will create fiscal pressure. In 2015, a person aged 20 to 64 had to support herself as well as almost three quarters of one other person not working. In 2060, this age-dependency ratio will increase to 92 percent, meaning that she has to support almost a whole other person not in work. A flexible pension age, which was implemented in the mid 1980s, goes some way to reducing that impact, but since demands and expectations on health and elder care, which are traditionally difficult to make more productive, are bound to increase rapidly, it suggests there might be problems ahead.

Sweden has one of the highest labour participation and employment rates in the OECD. The employment rate as a share of the working age population is 77 percent compared to an average of 69 to 70 percent in the OECD and the EU (OECD, 2023b). This is partly because of women's high labour participation rates in Sweden and other Nordic countries.

Sweden does not have a minimum wage, and the law does not prevent any job contracts, regardless of wage level. Sweden also has the EU's lowest level of occupational entry

regulations, like licensing requirements, and makes much less use of them than countries like the United States (Bambalaite, Nicoletti, and von Rueden, 2020). However, even though the overall strictness of employment protection is lower in Sweden than in southern Europe, it is higher than the OECD average for regular contracts (though much lower for temporary contracts) (OECD, 2023c).

According to Economic Freedom of the World data, Sweden is a serious laggard on the freedom from labour market regulations measure—it ranks 102 out of 165 countries (compared to 22 out of 165 for business regulations). Its poor labour market regulations ranking is largely a result of hiring and firing laws and collective bargaining in most sectors. Since the 1990s trade unions have imposed strong discipline on their members and tried to keep wage increases down so as not to hurt Sweden's international competitiveness. However, those same unions have also bargained to raise the lowest wages. Entry level wages in hotels, restaurants, and retail are around 87 percent of the median wage in those sectors, making it difficult for anyone who is 87 percent less productive than the median worker to get a job (Ekonomifakta, 2023b). This might have been a functioning model when Sweden had a very homogenous workforce with similar levels of education, but it makes it difficult for immigrants to find employment when they have less education and experience.

## Summary

Sweden has often been described as the very symbol of socialism and big government, but what people have in mind is the Sweden of the 1970s and 1980s. After this model developed serious economic problems in the early 1990s, Swedish politicians reduced the size of government substantially. A system that produced systematic budget deficits and high debt in the 1970s and 1980s has since then mostly run budget surpluses and paid down debt under a new set of relatively strict fiscal rules.

Sweden is now a fairly normal-sized western European welfare state, with less social spending as a share of GDP than countries like France, Germany, and Italy. The welfare state is generous, but redistribution mostly takes place over a person's life cycle, not between people. In other words, people receive generous benefits and services that they pay for themselves.

In the 1980s, Sweden had the highest tax levels in the world as a share of GDP, but they were reduced during the reform period. Most of the tax revenue now comes from flat payroll and income taxes. Sweden also relies on a high value added tax and excise taxes. Surprisingly to many foreigners, the Swedish tax system is now one of the least progressive in the OECD. The richest decile pays almost exactly the same share in household taxes as their share of market income. Sweden has abolished its taxes on wealth, gifts, or inheritance, and corporate taxes are below the OECD average.

## Notes

- 1 Göran Person speaking at Deloitte's Tax Day, November 24, 2021.





## THE EVOLUTION OF SWEDEN'S SOCIAL POLICY

Sweden's social policy stands out internationally for two reasons that are usually regarded as expressions of opposite ideological perspectives: First, social services and income supports are extensive and mostly universal, which explains the size of the Swedish welfare state since the 1970s. Second, since the 1990s Sweden has become a pioneer in privatizing social services, giving private providers the freedom to compete with public ones on similar terms and funding, and giving citizens the freedom to choose between different providers of elderly care, health care, preschool and education, including from among for-profit businesses. As of 2017, the last year for which data is available, the private sector provided approximately 17 percent of tax-funded social services according to Mårten Blix and Henrik Jordahl's *Privatizing Welfare Services*, the first major evaluation of this Swedish experiment (2021: 3).

The considerable reliance on the private sector to provide some services was a result of a surprising convergence of opinion from different groups with differing motives. First, in the 1980s there was growing popular discontent with the rapidly expanding public sector. People complained that they did not get the services they had been promised, that waiting times were long, and that the sector was not responsive to their needs and demands. A public evaluation initiated by the Social Democratic government concluded in 1990 that Swedes felt "powerless in silence" (SOU, 1990: 404).

At the same time, the center-right parties, inspired by the international political climate and by economists like Friedman and Hayek, but also by the economic failure of the policies of the 1970s, became increasingly free-market oriented in a way that they had not generally been when in government from 1976 to 1982. During the 1980s they came to see freedom of choice in the social services sector both as an ideological goal and as a way to make the public sector less inefficient and more innovative. When a center-right government under Carl Bildt took power in 1991, its government declaration promised a "freedom-of-choice revolution" and began to open up many of the public systems.

The Social Democrats were on the whole more resistant, but even there, some voices were pushing for more freedom of choice. In 1973, the Social Democratic economist Nils Lundgren wrote a report for the group tasked with writing a new party manifesto. He concluded that the old socialist ideal of giving people control of the means of production could only be accomplished through market mechanisms: by giving consumers the power over production through freedom of choice. Some in the party thought they needed to

involve private providers to invest in and expand public services. Labour unions, especially, played an important role. While socialist trade unionists rejected all privatization, the more pragmatic unionists, who were unhappy about the monopoly power of public service employers, became more interested in increasing the diversity of social services suppliers. (Whenever the Social Democrats have returned to power, they have often made peace with the freedom-of-choice systems, especially at the local level (Sjövall-Svanborg, 2011: chs 8-9).)

Because the leading parties have accepted the idea of private suppliers for public services, Sweden has been able to test how far a country can go in encouraging choice, competition, and entrepreneurship within a generous tax-funded welfare state and has ended up with an unusual combination of paternalism and privatization. This is why, paradoxically, Sweden has been described alternatively as a “socialist model” and a “neoliberal experiment” (Signore, 2017; Andersson, 2009, June 29).

### **Sweden’s Health Care System: A Competitive Public-Private Mix**

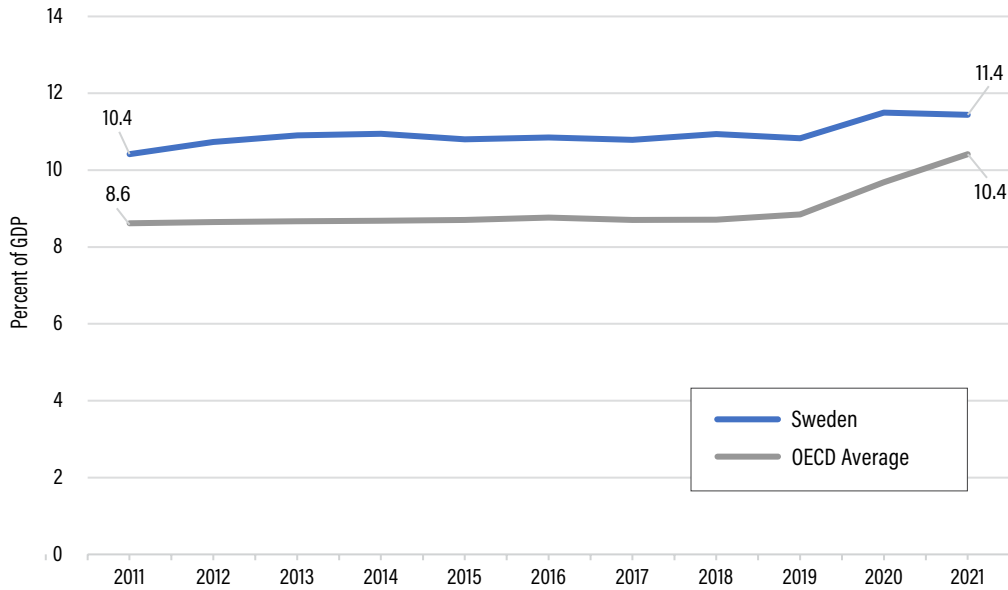
Sweden has public health care, but unlike the way the Swedish model is often described in North America, it is not a national, single-payer system. Sweden’s 21 regions are responsible for funding and providing health care, and its 290 municipalities are responsible for elder and home care. Regions are the largest spenders on health care (67.9 percent), with municipalities in second place (30.6 percent) and the national government far the tiny share that remains. This means that almost all of the funding for Sweden’s health care comes from local, proportional income taxes.

The central government’s role is to guide health policy, set the rules, and add specific grants based on need or to fund special initiatives, such as reducing waiting times. The regions set budgets, impose the necessary tax, and choose the model for remuneration to providers, which is in most cases an updated combination of different forms of remuneration. The most common one is capitation, a set amount for each patient enrolled, but adjusted for socioeconomic factors. Fifteen regions with 84 percent of the population also use some form of pay for performance, based on providers achieving specific, quantifiable goals.

As Figure 4.1 shows, health care spending in 2021 was 11.4 percent of Sweden’s GDP, slightly higher than the OECD+1 average of 10.4 percent. This amounts to US\$6,262 per person (Figure 4.2), ranking Sweden 7<sup>th</sup> highest spender on health care out of 38 countries on an age-adjusted basis. In 2020, private spending was 14.09 percent of the total (WHO, 2023).

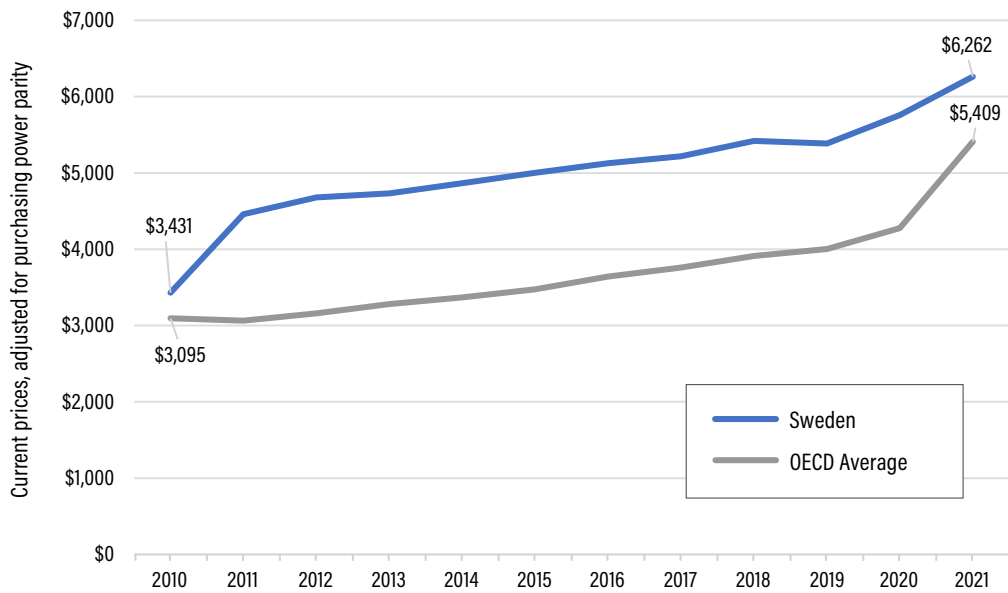
The health care benefits Sweden provides include primary care, inpatient and outpatient specialty care, emergency care, inpatient and outpatient prescription drugs, mental health care, rehabilitation care, medical devices, transportation services, home and long-term care, and dental care for children and the young.

Figure 4.1: Health Expenditures as a Percent of GDP, Sweden vs. OECD Average (2011–2021)



Source: OECD (2022e).

Figure 4.2: Current Health Expenditures Per Capita (2010–2021)



Source: OECD (2020e).

The public role in health care expanded rapidly in the 1970s. The pivotal change was the implementation of the bipartisan “Seven Crowns Reform” of 1970. Under that reform regions took over the employment of doctors and equalized wages between different

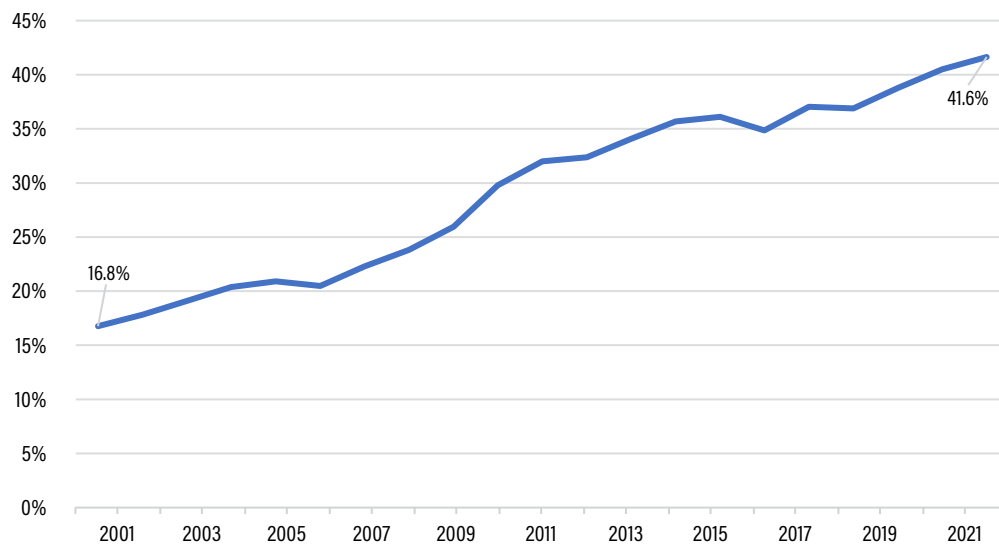
specialties. Doctors could no longer run a private practice at the hospital where they worked. Patients had to pay only a uniform low fee of SEK7 per visit – an estimated quarter of the cost – with the rest covered by taxes. In 1971, the government took over all private pharmacies and created a national monopoly.

Equalized wages, ease of access, and low prices had unintended consequences. Almost immediately a shortage of doctors appeared in certain specialties, and patients complained that they had lost the close, recurring relationship they'd had with a family doctor. Demand for health care grew and public hospitals soon experienced funding shortfalls and had long waiting lists.

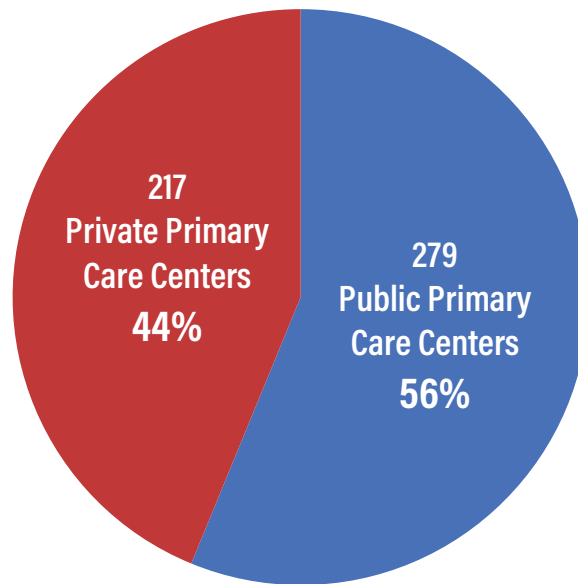
Privatization and better incentives were seen as solutions to these problems. On the local level, private providers took on a larger role in the 1990s, especially in primary care, and several regions implemented freedom-of-choice models. In 2000, the Stockholm region privatized a major emergency care hospital, Saint Görans Hospital. It is run by a publicly traded company, Capio. A 2015 study by the Region of Stockholm showed that it paid 11 percent less for treatment at Saint Görans than at two comparable public hospitals. At the same time, staff and patients were more satisfied at the privatized hospital (Stockholms läns landsting, 2015).

The major national turning point was the center-right government's 2009 *Law for Freedom of Choice in Health Care*. It required all regions to give all patients the right to choose their primary care provider and stipulated that all facilities fulfilling certain criteria and chosen by the patient should get public funding for its services. The share of county council primary health care spending that goes to private providers increased rapidly as a result, from 17 percent in 2001 to 42 percent in 2021 (see Figure 4.3) (Blix and Jordahl,

**Figure 4.3: Country Councils' Purchase of Primary Care From Private Providers as a Share of Net Costs (2001-2021)**



Sources: Statistics Sweden (2022a; 2022b); Blix and Jordahl (2021): 73.

**Figure 4.4: Breakdown of Public and Private Primary Care Centers in Sweden (2019)**

Source: Montagu (2021).

2021: 73). As shown in Figure 4.4, 44 percent of Sweden's primary care centers are privately run (Montagu, 2021).

In 2015, the new *Patient Act* expanded patients' freedom of choice by giving them the right to choose specialty providers as well, even if they are private providers or are based in another region. Patients were also granted expanded rights to demand a second opinion in another region. Patients must have a referral from a general practitioner to get a tax-funded appointment for specialized care. The private sector has not expanded much in specialty areas and continues to provide around 7 percent of specialty care. Sweden has 70 regional and seven university-owned hospitals. There are six privately owned hospitals, three of which are non-profits.

A majority of municipalities have adopted a similar freedom-of-choice model for home care for the elderly, where providers are paid a fixed hourly price, adjusted for area and type of service. Freedom of choice is much rarer for nursing homes. Instead, those homes are usually outsourced to providers based on price, or quality, or a combination.

There was also a major national pharmacy reform in 2009. It gave private companies freedom to compete with the old public sector monopoly. At the same time, 615 of the 955 government pharmacies were privatized and commercial retail stores were allowed to sell non-prescription medicines (Riksrevisionen, 2012). The following years saw a rapid increase in the number of pharmacies in Sweden.

Sweden imposes a fee for visits to health care providers to discourage unnecessary or frivolous visits. User charges are set locally and differ over the country. For a visit to a primary or specialist provider, the patient is expected to pay a fee of between SEK140

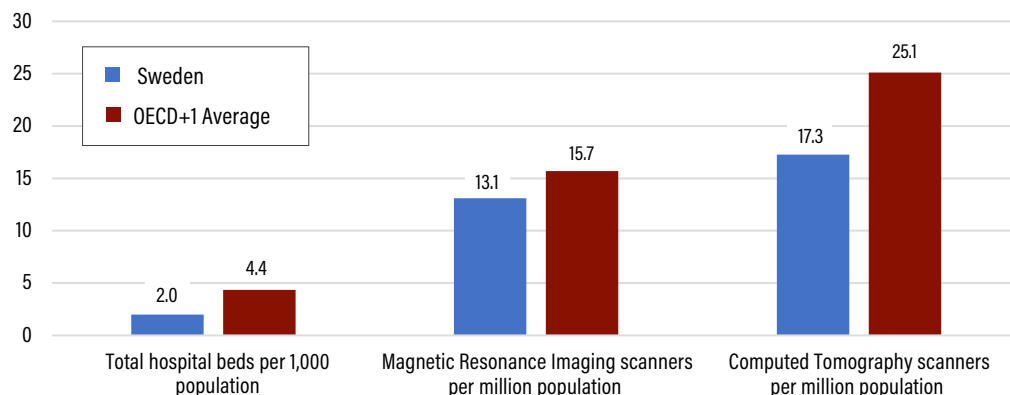
and 350 (US\$13 and \$33). In 2019 an emergency room visit cost SEK200 to 500 (US\$19 to \$47). There are annual caps on user charges, calculated on a sliding scale. The more a patient spends over the course of a year, the more the national government covers. The same goes for the cost of prescription drugs. Out-of-pocket spending is 13.8 percent of total health care spending (OECD 2021e).

Private health care insurance has become popular in recent years but is still used only minimally compared to other OECD countries. By the end of 2022, 760,000 people held a voluntary health care insurance policy, representing almost 15 percent of employed persons that year (Svensk Försäkring, 2023, March 31). Usually employers buy the insurance to make sure that employees have quick access to specialist care and do not have to wait in queues.

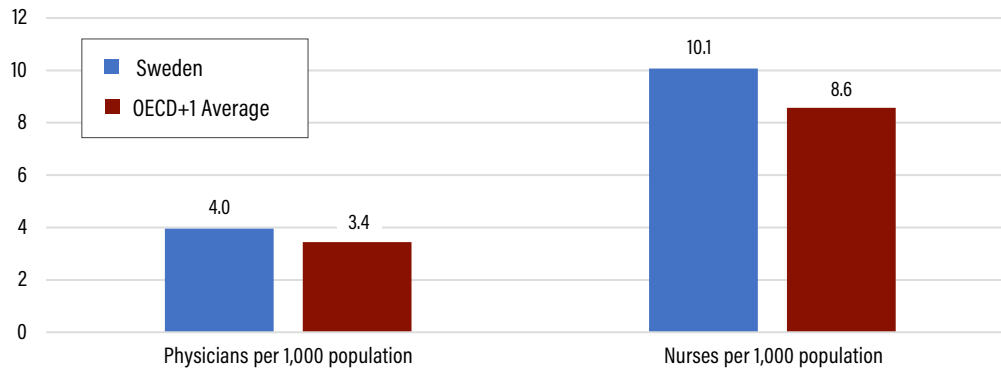
It is interesting to note that certain areas of health care are completely left outside the public system. Dental care is tax-funded for children and youth under 23 years, but is not normally covered for adults. Private clinics usually provide dental care for adults; prices are unregulated and the bills are paid out of pocket. One could make the case that it is inconsistent to be subsidized by the government if you have problems hearing, but not if you have problems seeing. Hearing aids are subsidized, but eyeglasses, contact lenses, and eye surgery are not, even though it is difficult to say that one need is greater than the other. Of course such contradictions are inherent in the very nature of a tax-financed system with potentially unlimited demand. At the end of the day, someone (in this case politicians and bureaucrats) has to decide which demand will be accepted and which denied.

In international comparisons, Sweden's health care system is close to the top or to the bottom, depending on which measures you look at (OECD, 2021e). Sweden has relatively few hospital beds, and the number has been decreasing because of conscious efforts to divert care from hospital inpatient care towards outpatient and primary care. In 2018, Sweden had 21,754 hospital beds (2.14 per 1,000 people), down from 31,765 (3.58 per 1,000) in 2000. As Figure 4.5 shows, in 2018, adjusted for age Sweden only had 2.0 hospital beds per 1,000 population, ranking 37<sup>th</sup> out of 38 OECD+1 countries. The pattern

**Figure 4.5: Physical Health Care Resources in Sweden and the OECD+1 (2018)**



Source: OECD (2020a).

**Figure 4.6: Human Health Care Resources in Sweden and the OECD+1 (2018)**

Source: OECD (2020a).

is similar for emergency care beds. Adjusted for age, Sweden had 13.1 MRI scanners and 17.3 CT scanners per million population in 2018, ranking 18<sup>th</sup> and 24<sup>th</sup> out of 38 countries, respectively.

Swedish health care is well staffed, though. In 2017, Sweden had 42,898 practicing physicians (4.27 per 1,000 population), up from 24,837 (2.81 per 1,000) in 1995. As Figure 4.6 shows, adjusted for the age distribution of the population, Sweden had 4.0 practicing physicians per 1,000 population (ranking 8<sup>th</sup> out of 39 countries). Similarly, Sweden had 10.1 practicing nurses per 1,000 population, age-adjusted (ranking 13<sup>th</sup> out of 38).

The ostensibly high number of health care providers does not mean that patients get a lot of time with medical providers, though. On an age-adjusted basis, Sweden reports only 2.5 annual consultations per capita and 12,935.9 inpatient care discharges (ie., the release from hospital of a patient who was admitted for one or more nights) per 100,000 people (ranking 35<sup>th</sup> out of 36 and 25<sup>th</sup> out of 38 countries).

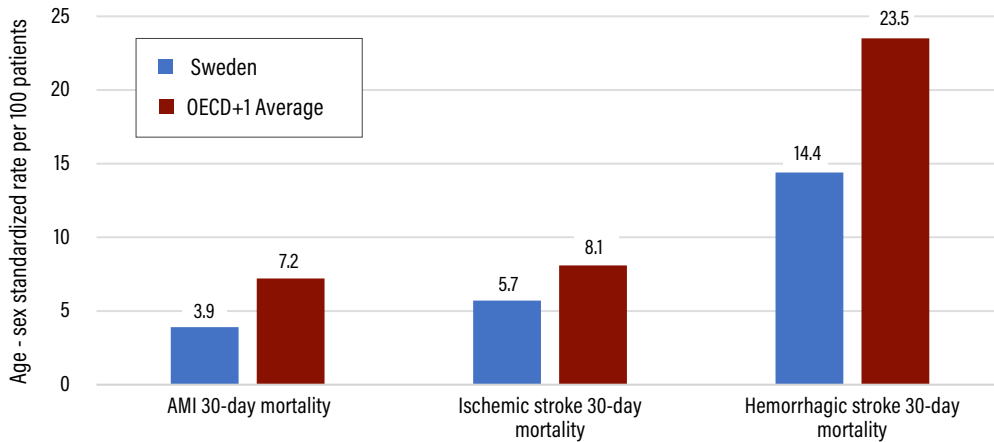
On the other hand, on many outcome-based measures, like age- and sex-adjusted clinical performance and health status, Sweden performs better than the OECD average. Figure 4.7 shows 30-day clinical mortality rates for three conditions. Sweden reports a mortality rate after an acute myocardial infarction of 3.9 per 100 patients, compared to an OECD average of 7.2 (making it 6<sup>th</sup> out of 36 countries). Its 30-day mortality rates following hemorrhagic stroke (14.4 per 100 patients over the age of 45) and ischemic stroke (5.7 per 100 patients over age 45), make it the 3<sup>rd</sup> and 10<sup>th</sup> best out of 35 countries.

Figure 4.8 shows that Sweden also performs relatively well on cancer survival rates, ranking 5<sup>th</sup> for breast cancer, 7<sup>th</sup> for cervical cancer, 9<sup>th</sup> for colon cancer, and 12<sup>th</sup> for rectal cancer out of 33 countries.

Sweden's overall health status indicators are also better than the OECD+1 average. Its life expectancy at birth (82.4 years) and its healthy age life expectancy (71.9 years) make it the 9<sup>th</sup> and 8<sup>th</sup> best out of 38 countries (see Figure 4.9). Sweden's infant mortality rate (the probability of dying before age 1) at 2.1 per 1000 live births is the 7<sup>th</sup> lowest in the

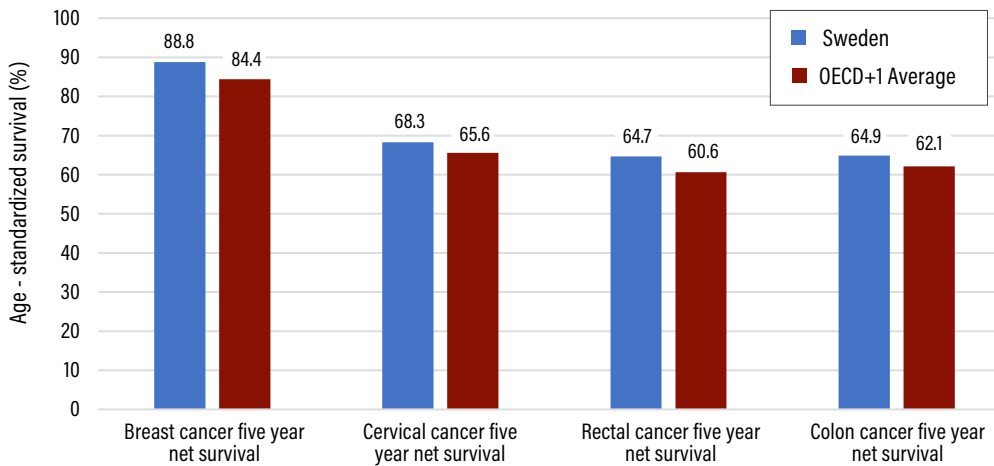


Figure 4.7: Clinical Mortality Rates (2017)



Source: OECD (2020b).  
 Note: Data for Singapore is from OECD 2018.

Figure 4.8: Cancer Survival Rates in Sweden and the OECD+1 (2017)



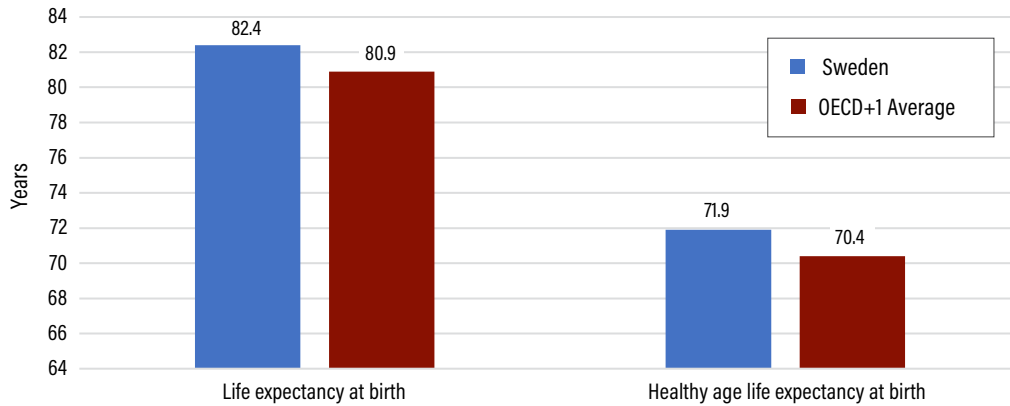
Source: OECD (2020b).

OECD+1. Its overall treatable mortality, at 51 deaths per 100,000 people, is the 9<sup>th</sup> lowest. However, it must be kept in mind that health status is not just an effect of health care, but is heavily influenced by differences in lifestyle, like smoking, exercise, and diet, where Swedes tend to make healthier choices than do citizens in some other OECD countries.

In Sweden, one of the most common complaints relates to the long waiting times for care, but compared to other OECD countries Sweden is doing relatively well. Consider Figure 4.10, which indicates that 35 percent have to wait more than three months for a hip replacement, 46.3 percent for a knee replacement, and 19.9 percent for cataract surgery, ranking Sweden the 4<sup>th</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> best out of 15 countries for which there is data.

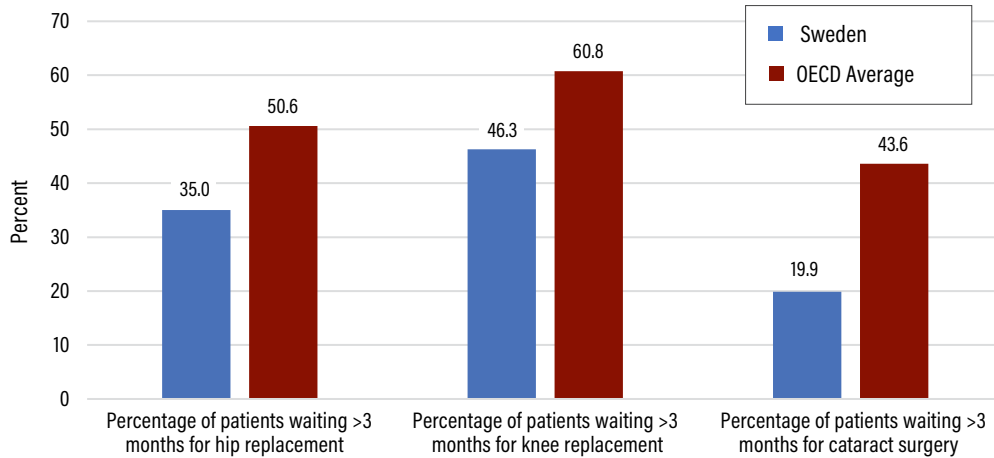
On health care quality, studies find only small differences between public and private health care providers. Where there are differences, they point to somewhat higher quality

Figure 4.9: Life Expectancy and Healthy Age Life Expectancy (2019)



Source: WHO 2020.

Figure 4.10: Wait Times from Specialist to Treatment (2018)



Source: OECD (2020a).

among private providers. There is some evidence that private providers have higher productivity, too. Greater accessibility of care has benefited all groups, but high socioeconomic groups have benefited the most. When reimbursement models have been more dependent on performance and activity, it has benefited socioeconomically weaker groups more (Blix and Jordahl, 2021: ch. 5).

In elderly care, private providers have a cost advantage. Studies have found another interesting difference: Public nursing homes tend to perform better on structural measures, such as the number of employees per resident, but private nursing homes perform better on process measures, such as participation, choice, and screening for falls, pressure ulcers, and malnutrition. In home care, user satisfaction has increased after the introduction of freedom of choice. Since there is no difference in satisfaction between the public providers, this seems to be an effect of competition and the ability to choose between alternatives in and of itself (Blix and Jordahl, 2021: ch. 5).

It is easy to measure staffing and costs, but it is more difficult to estimate quality. One study tried to do that by looking at mortality. It found that the introduction of private nursing homes extended the life expectancy of residents by reducing the mortality rate by about 1.7 percent, while at the same time reducing costs (Bergman, Johansson, Lundberg, and Spagnolo, 2016).

However, privatization within a tax-funded system is not a cure-all, and though it can often reduce per unit costs, it can increase total costs. Before the system for elderly care was opened up to private providers, rights to access home care were granted by law, but could often be hollowed out in an opaque way by municipal managers who faced little oversight. Once private alternatives were allowed, all the care homes, public and private, had an incentive to provide the elderly with every single hour and service they were entitled to according to the regulations. This is popular, but costly.

Something similar can be seen with the rise of telemedicine. In recent years, Swedish patients have increasingly used their right to seek treatment anywhere in Sweden by calling a telemedicine company based in another region, which is then reimbursed by the patient's home region. Encouraging innovation like this was one of the rationales behind the reform, and it helps shift visits away from offices thereby increasing both efficiency and convenience. However, when access is this easy and convenient, and when neither patient nor company has an incentive to ration the number of calls, it can become costly for taxpayers. As a result of such unintended consequences local politicians are constantly tinkering with the remuneration structure and gatekeeping functions.

### **Summary**

The Swedish health care system is not the single-payer national system many North Americans assume it is. Health care is run by Sweden's 21 different regions and is mostly paid for through the local flat tax. Furthermore, since the 1990s the health care and elderly care systems have been opened up to private providers to improve efficiency, innovation, and availability. National law forces regions to let patients use their health funding to buy care from private providers. Almost every fourth krona spent on primary health care in Sweden goes to a private provider.

While Sweden spends more on health care than the average OECD country, the difference is marginal, which is perhaps somewhat surprising given Sweden's reputation as a welfare state. Moreover, participation in the health sector by the country's robust private sector with the added component of substantial consumer choice reflects an acknowledgment that centralized management—if not public funding—has its efficiency limits.

### **Education Provision in Sweden: Unique in the OECD**

Interestingly, privatization in the social services sector arrived first in the area where Sweden's government had expanded the most in comparison to other countries. In 1975, the Social Democratic government started a massive rollout of public preschools, partly

to get more women into the labour market. Municipalities were to offer families heavily subsidized preschooling that was to be funded by central government grants. (In Sweden, preschool is organized daycare for children from age 1 until they start school.)

The number of children in preschool almost doubled in five years. (The proportion in preschool expanded from around 15 percent of children in 1975 to more than 90 percent in 2022). But despite this rapid expansion, demand was much greater than politicians had planned for. There were complaints from parents who had ended up on long waiting lists and families who had relocated to different cities but could not find a preschool in the new one. These complaints made it difficult to resist calls for a larger role for private providers and in 1984 co-ops run by parents were also given public grants.

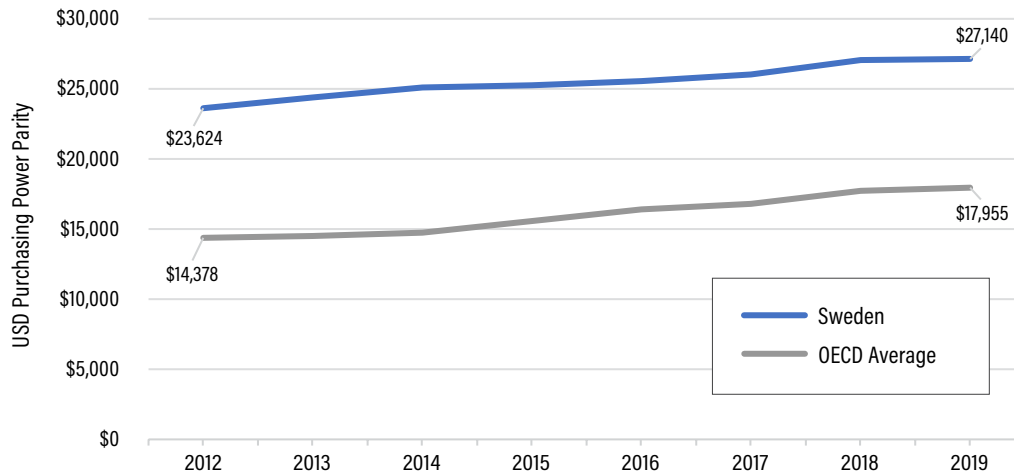
At the same time, an attempt to start the private for-profit preschool Pyslingen, owned by the home appliance manufacturer Electrolux, became very controversial, partly because it was seen as a Trojan horse that would introduce freedom of choice in the welfare state more broadly (a concern that was not without reason). The Social Democratic prime minister, Olof Palme, railed against what he saw as “Kentucky Fried Children.” A national law, aimed squarely at Pyslingen, asserted that municipalities that funded for-profits would lose central government grants worth a similar amount. This did not stop some municipalities from circumventing the law’s intention, however, and eventually even some Social Democrats started seeing that private preschools were necessary to help municipalities satisfy demand.

One of the first things the new center-right government did after it won power in 1991 was remove the ban on municipal grants to for-profit preschools, as long as they upheld certain pedagogic standards. But municipalities could still reject them. This changed in 2006 when the government established the right to start an independent preschool and grants had to be given, no matter the organizational form. Since then, the share of children in private preschools has increased to more than 20 percent.

The most radical reform of the Swedish welfare state, and the one that has received most international attention, was the implementation of freedom of choice in education. In 2019, per-student public school spending in Sweden (US\$27,140, adjusted for purchasing power parity), significantly exceeded the OECD average of \$17,955 (see Figure 4.11). Since 1992, most of that money has followed the pupils. That year, the government abolished the public school monopoly and replaced it with a national school voucher system, first for compulsory schooling (for pupils aged 7 to 16, boosted in 2018 to pupils aged 6 to 16), and expanded a year later to upper secondary school (ages 16 to 18).

This change had been preceded by another large reform. In 1989, a Social Democratic government decided to move the operational authority over schools from the central government and delegate it to the municipalities, and from then on funding for schools came from the local, flat income tax. The 1992 “free school reform” initiative brought in by the following center-right government required municipalities to give families the right to choose the school their children attended, public or private, non-profit or for-profit, in

**Figure 4.11: Total Educational Expenditures Per Full-Time Equivalent Student, Public Educational Institutions**



Source: OECD (2023d).

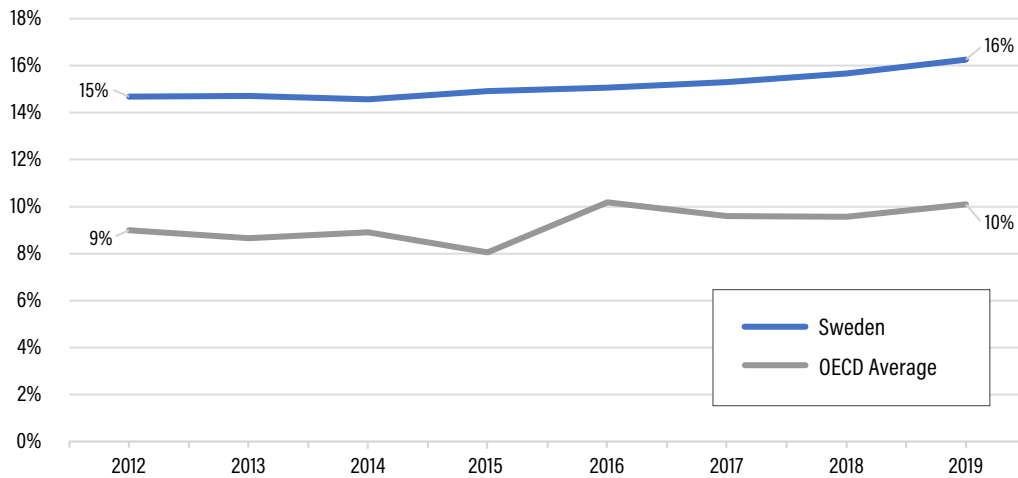
the home municipality or in another. The funding for schooling would follow the child and could be no less than 85 percent of the cost for the average child in a public school. Private schools could supplement the voucher with a school fee.

The Social Democrats at first criticized the reform for being rushed, but quickly came to accept the system and even praised it for encouraging diversity and improving learning. In 1996, a Social Democratic government banned schools from charging tuition, but raised the voucher to 100 percent of the average cost. Sweden is still home to some independent schools outside the free school system, which do charge tuition, but very few remain. Figure 4.12 shows the share of all publicly funded students enrolled in privately run schools in Sweden and in the average OECD country. While 10 percent of publicly funded students attend privately-run schools in the OECD, 16 percent of Sweden's publicly funded students attend privately-run schools.

Even though Sweden has gone further than most countries in encouraging and supporting school choice, national regulations have increasingly restricted diversity. In order to qualify for the voucher system, a school has to be approved by the National Agency for Education and follow the national curriculum and national subject plans. This is controversial, since the national curricula since the early 1990s increasingly emphasized progressive pedagogy taught using more student-centered approaches. Teachers are not permitted to assign student grades prior to Grade 6, and behavioural grading is banned. Hours of instruction devoted to particular subjects are regulated in compulsory schooling, limiting a school's ability to develop a unique profile. Since 2010, for most subjects schools have been required to hire only licensed teachers as permanent employees.

Independent schools must be open to all children, assuming they have the space, and exceptions can only be made for geographic proximity, if the schools so choose, and for siblings of pupils. They are not allowed to expel a child, even for consistent misbehaviour.

**Figure 4.12: Percent of All Students Enrolled in Privately-Run Schools Through Publicly-Funded Vouchers**



Source: OECD (Undated d).

The inability to charge tuition limits school budgets and the ability to offer unique services to students, and regulations limit their ability to experiment with innovative approaches and offerings. Even though the Swedish education system is sometimes referred to as “the market school,” especially by its detractors, this market has no price mechanism. In many ways, Swedish free schools resemble North American charter schools more than those operating in a genuine free market.

Still, compared to the OECD average, both public and private schools in Sweden have a higher level of autonomy on both principal decision-making over the use of school resources and teacher decision-making.

In 2021-22, 828 out of 4,744 primary school units were independent, of which 511 were run by joint-stock companies. On average, in 2021-22 16.2 percent of all children went to an independent school, up from less than one percent before the 1992 reform. In secondary school, as many as 30.5 percent of all students went to a private school that year (Skolverket, Undated). These numbers vary across the country. In some municipalities enrollment in independent schools is zero percent, and in others, almost 50 percent.

Data suggests that the voucher system has improved the school system. Studies show that a larger share of independent schools in a municipality improves education results, but interestingly not just in the free schools, but in public schools located close by as well, thus proving that competition improves the overall outcome (Sandström and Bergström, 2005; Böhlmark and Lindahl, 2015). A review of the research concludes that “the introduction of independent schools has increased the productivity of the Swedish school system. This is most evident for the compulsory level, where competition has raised student performance without raising costs” (Blix and Jordahl, 2021: 135).

However, the research has found more mixed results for upper secondary education. Students in independent schools have better test results and grades and are more likely to graduate on time. However, there is some evidence that on externally graded tests students at independent upper secondary schools perform worse; they appear to benefit from more lenient “internal” grading.

Grade inflation is now well-documented, especially at independent upper secondary schools. This should not have come as a surprise. Families are eager for their children to get higher grades, schools want to keep them happy, and Sweden has no institutions to counter these incentives. There is also evidence of grade inflation in public schools. Teachers are free to set grades without external guidelines and internal tests are not standardized. Sweden is also the only European country except Spain where the final grade at the end of secondary education does not include any kind of final examination, not even an internal examination. A system of national, standardized tests was extended after 1997, but the tests are still graded by teachers at the same school, and they have a tendency to be more lenient than external teachers.

Studies by the Swedish School Inspectorate show that children in free schools have more favorable attitudes to their school than do children in public schools for 13 out of the 14 indicators used. The greatest difference was documented in the area of respecting differences, preventing abuse, and addressing gender equality. The only area where public schools performed better was the share of students who said it was ok to leave the classroom if they felt the need to see a school nurse or school counselor (Skolinspektionen, 2017).

Segregation has increased in Swedish schools since the early 1990s. This, however, seems to be mostly the result of an increase in residential segregation. Public and private schools have roughly the same share of children from immigrant backgrounds, and parental background has not become more important for the success of pupils. Parents with children in independent schools, especially non-profits, have a slightly higher formal education level (Blix and Jordahl, 2021: 133ff). For-profits might even do more than non-profits to reduce segregation since they expand and build new schools if they are in high demand, while non-profits often stick with their old customer base.

Opposition to the voucher system began to surface during the 2010s. One reason for the disapproval was that to get the Left Party’s votes so it could form a government in 2014, the Social Democrats had to promise the Left Party that it would campaign to limit profits in the school system. No suggestion in that direction got a majority in parliament, but it re-energized and polarized the debate about free schools.

Around the same time it became clear that Sweden had experienced a steep decline in student achievement, especially in international, standardized tests by the Programme for International Student Assessment (PISA). Swedish public and independent schools exceeded the OECD average on PISA tests in reading, mathematics, and science in the early 2000s, but fell below that average by 2012. This triggered a national debate about the crisis in education, and many used this to blame the voucher system for the problems.

However, this explanation does not fit the data on the results in free schools (which performed slightly better) and public schools close to them. Gabriel Heller Sahlgren (2016) summarizes:

Research has indicated that the performance of independent school students, as well as the competitive presence of independent schools, has moderated, rather than exacerbated, the decline in Sweden's student performance on international standardized tests.

Anders Böhlmark and Mikael Lindahl give further details when they report that:

A 10 percentage point increase in the share of independent school students has resulted in close to a 2 percentile rank higher educational achievement at the end of compulsory school and in high school, a 2 percentage point higher probability of choosing an academic high school track, a 2 percentage point higher probability of attending university, and almost an additional 4 weeks of schooling. (Böhlmark and Lindahl, 2015: 542)

Furthermore, the PISA results improved in 2015 and 2018, recovering around 65 percent of the initial decline. After first having outperformed the OECD average, and then underperforming it, Sweden is once again above average. Between 2012 and 2018, when Sweden's results improved, the proportion of students enrolled in independent primary schools increased from 13 to 16 percent.

A number of other factors have been suggested in the ongoing debate over the cause of the 2000-2012 decline in Sweden's PISA test results. Many different changes took place in the country the decade before. Sweden became more of an immigrant country. It has admitted more refugees per capita than other European countries for decades, and more often from families with less education. The PISA test results are very different once this reality has been adjusted for: of the results in 2018 for pupils with at least one parent born in the country, Sweden scores as one of the best countries (it shares second place and is significantly outperformed only by Estonia). Sweden is one of few countries that come close to the top in all three different OECD tests of pupils, adjusted for background (Sahlgren, 2022).

Furthermore, just before the voucher system was introduced, responsibility for the whole school system was moved from the national government and delegated to municipalities that did not have any experience with education. Many dealt with it well but the difference in size and professionalism between municipalities is great, and it might have taken some of them time to adjust to their new responsibilities.

In the early 1990s, the national curricula also took on increasingly progressive forms, criticizing teacher-led instruction and encouraging the child's natural ability to learn. At first, independent schools were not forced to follow the new guidelines, but a 1996-97 law dictated that those schools should be grounded in the same values and have the same goals as public schools. "Teachers will never get their old status back," explained the



Social Democratic school minister Ylva Johansson: “Our school has let go of the old claim of having the monopoly on knowledge. It has abandoned teacher-centered teaching and classroom teaching. It is now an arena for processing information – you create knowledge.” She added: “It may look messy, much like preschool, but in fact it is the result of creative ideas and well-thought-out pedagogy” (Lönnroth, 1997, August 17).

According to Sahlgren, preschool behaviour is exactly what we started seeing in Swedish schools:

Indeed, higher shares of Swedish students arrive late for school than in any other OECD country, and the disciplinary climate is also worse than in the OECD on average. Furthermore, students in Sweden appear to have comparatively low levels of perseverance. (Sahlgren, 2016)

The debate has sharply turned against progressive educational ideals, especially after the drop in PISA rankings. In a remarkable 2016 article, a professor of pedagogy apologized for the ideas of the 1990s and said he contributed to spreading ideas that were “hostile to teaching” (Linderöth, 2016, August 24). Partly as a reaction to this “*flumskola*” (spaced-out schooling), ensuing center-right governments from 2006 to 2014 imposed tighter rules on schools and teaching, but the unintended consequence was to further limit the room for experiments and innovation in independent schools. Two typical decisions by this more dirigiste center-right government were the requirement that teachers should be licensed and a ban on homeschooling (which has never been much in demand in Sweden) except in exceptional circumstances.

The debate over Sweden’s decline in PISA test scores from 2000-2012 is still not settled, and by now it is almost over-explained, yet none of the explanations can give a convincing explanation for the ensuing improvement, when Swedish schools, adjusted for background, got better grades than almost all other countries. A completely different and speculative explanation should be mentioned: What if Swedish students just don’t care much about standardized international tests? We explore the rationale for this speculation below.

In an experiment in secondary schools in China and the US, one group of students answered questions in mathematics from the PISA test. Another group answered the same questions, but were also told that they would receive 25 dollars if they got through the test without errors, and that one dollar would be taken away for every mistake. Interestingly, Chinese students who got this financial incentive did not perform better than Chinese students who didn’t, which suggests that they already exerted maximum effort, perhaps because they faced strong pressure from the school and authorities to perform well. But American students who could make money suddenly performed better than Americans who just fought for national glory in the international rankings (Gneezy, List, and Livingston, 2019).

An admittedly speculative hypothesis is that increasingly individualist Swedish students started caring less and less about international tests that have no effect on their individual

grades and future. However, once declining performance became an international embarrassment and led to a hot-tempered debate over the educational system, perhaps school administrators and teachers started to pressure students to exert more effort to do well on those international tests.

Sweden has around 50 universities and university colleges. Most of them are run by the government, but some of the most prestigious are private, like the Stockholm School of Economics and Chalmers University of Technology in Gothenburg. One of the most regressive aspects of the Swedish education system is that the government fully subsidizes tuition fees, in effect redistributing funds from the less educated to the well educated. Despite this, the share of Swedes 25 to 34 years old with a tertiary education is not much higher than the OECD average, 49.1 versus 45.6 percent, and is lower than in the United States, the United Kingdom, and Canada (OECD, 2022f).

One side effect of funding students generously is that they spend a longer time finishing their studies, which delays their entry into the labour market. The average age for concluding a tertiary education is five years older in Sweden than in the average OECD country (Svenskt Näringsliv, 2018).

### **Summary**

The Swedish school system is unique internationally. It has a national school voucher system that gives families the right to choose the school for their children, whether it be public or private, non-profit or for-profit, faith-based or non-faith-based. Schools are controlled by a national curriculum and national regulations but have comparatively more managerial freedom and must compete for pupils for their funding. In many respects, the school system is more free market-oriented in Sweden than in any other OECD country. As with health care, Sweden's approach to education combines more spending with more market-oriented choice.

### **Income Support System: Generous with Distinctive Features**

Sweden's income support system is one of the most generous in the OECD, especially for families with children. However, as stated previously, more than 80 percent of redistribution takes place over an individual's life cycle, not between individuals. Swedes get generous benefits and government services, but they mostly pay for them themselves; the benefits are not a handout taken from a small group of rich people (Pettersson, Westberg, and Pettersson, 2006).

Several different government agencies managed the income support system in Sweden. The Swedish Pensions Agency is responsible for old-age pensions, the Swedish Social Insurance Agency administers social insurance, and the Ministry of Employment is in charge of unemployment benefits. Social assistance is operated jointly by local municipalities and the National Board of Health and Welfare.

## Pensions

The area in which Sweden has attracted the most international interest is old age pensions. Sweden's pension system was recently described as the world's best by the insurance group Allianz in its *Pension Report*, based on its sustainability and adequacy (Allianz, 2020). However, it took a complete makeover of the system in the 1990s to get Sweden to that position.

Sweden's old ATP (old age pension) system was a pay-as-you-go, defined benefits system, of the sort that is common in other welfare states, and it was not financially viable in the long run. Pension benefits were tied to changes in prices, but not to economic growth and demographic changes. As life expectancy increased, the fertility rate declined, and economic growth disappointed, returns were no longer sufficient to give the elderly what they had been promised. Forecasts predicted that the system was in danger of becoming insolvent by the early 2000s.

In 1991 the government appointed a working group and tasked it with making the pension system sustainable by increasing savings, encouraging work, and tying pension benefits more closely to the individual's labour market earnings. The result, agreed on by both the Social Democrats and the center-right was an entirely new system based on the principle that pensions should generally correspond to what the individual pays into the system. It is a system where the contributions are defined, not the benefits.

The system was started in 1999 and has three components: an income pension, a premium pension, and a guaranteed pension. The government withholds 17.21 percent from all wages as a pension contribution, including from the self-employed. Of this, 14.88 percentage points go to the income pension and 2.33 percentage points to the premium pension. The *income pension* is a pay-as-you-go system that is paid for with defined contributions based on each Swede's lifetime earnings. There is both a lower and an upper limit on assessed pensionable income. In 2020, workers had to make at least SEK20,008 in order to have pensionable income credited, and for incomes above SEK501,000 contributions are not pensionable. This ceiling is indexed so it rises with inflation.

There is no longer a fixed retirement age in Sweden and you have to apply when you want to start withdrawing your pension. You are allowed to start doing so when you reach age 63, but this age rises with life expectancy. The longer an individual waits to take their pension, the more they receive. In 2020, the average labour market exit age in Sweden was 65.4 years, the oldest in the European Union after Latvia. The OECD average is 63.1 years (OECD, Undated c).

The least popular part of the pension system—and the most important one—is its automatic balancing mechanism, the so called “brake.” The brake automatically adjusts the pension benefits to changes in the economy, unemployment, and demography, so that the system does not suffer from deficits. Sweden has a sustainable pension system for the simple reason that pensions are reduced when the economy is doing worse than expected. When the economy picks up again, the brake is released.

The *premium pension* is an individual, fully funded, mandatory savings system. Workers are allowed to choose up to five different funds in which to invest their premium pension according to their own risk preference. These can be changed at any time free of charge. Payments from the premium pensions differ as they depend on the yields on the individual investments.

The *guaranteed pension* is a means-tested supplement to the two income-based pensions and is only paid to Swedes with a small pension entitlement or none. Pensioners must reach age 66 and have been residents of Sweden for at least 3 years to receive partial benefits or 40 years for a full guaranteed pension. In 2020, the full guaranteed pension was SEK8,597 per month.

### **Unemployment benefits**

Unemployment insurance in Sweden differs from that in many other welfare states in that it is not mandatory. Most other European countries have comprehensive schemes, as Britain does, or state corporatist schemes separated along occupational lines, which are more common on the continent. Both of these types of unemployment insurance are compulsory. The Swedish system, on the other hand, maintains many elements from the earliest unemployment schemes, which were mutual insurance systems run by trade unions or friendly societies. Unemployment insurance in Sweden is still voluntary, but is regulated by and subsidized by the government.

To be eligible, you have to have paid membership fees for a minimum of 12 successive months to one of 25 different unemployment insurance funds, most of them based on occupation or industry and run by trade unions. However, the government also contributes to this insurance from a proportional payroll tax of 2.64 percent on all wages, whether or not the worker decides to insure themselves. This combined funding makes up almost 75 percent of the unemployment compensation, creating a strong incentive to join an insurance fund. Around 70 percent of the workforce does.

Unemployment benefits are related to the claimant's income in the past 12 months. Benefits are 80 percent of the claimant's average income (up to SEK910 per day) for the first 200 days, down from 90 percent before 1993. After 200 days, the benefit is reduced to 70 percent. The claimant has to be willing to accept employment and the fund can stop or reduce payment if the claimant is fired for misbehaviour, quits their job without good reason, or turns down suitable employment offers.

There is also a basic unemployment insurance, set at SEK365 a day, for those who are not eligible under the voluntary scheme. Workers have to prove that they are actively seeking work and the duration of the benefit depends on the number of hours worked.

To qualify for either of the two schemes, individuals must have worked for at least 80 hours per month in the past six months or 480 hours during a six-month period in the past 12 months. Unemployment benefits are paid for a maximum of 300 days for most adults and up to 450 days if the recipient has children under the age of 18.

Overall, the generosity of Sweden's unemployment benefits are close to the European average, with a net replacement rate (i.e., net income while out of work divided by net income while in work) slightly above the OECD average.

### ***Sickness benefits***

Sweden has a generous sick-leave benefit that has at times resulted in one of the world's healthiest populations being off sick from work more often than any other population. In the 1980s, the sickness benefit was 90 percent of the worker's salary, and collective agreements on top of that meant that many workers had almost full pay even when they were on sick leave. It has been documented that Swedish men reported sick at the time of major sporting events broadcast on TV suspiciously often (while women's health was not adversely affected by sports on television) (Thoursie, 2004).

In the early 1990s, the benefit level was substantially reduced and a first-day deduction was implemented (meaning that the worker is not compensated for the first sick day) to discourage workers from taking sick-leave unnecessarily. Between 1988 and 1997, the share of the private workforce claiming sick leave benefits declined from a whopping 9.7 percent to 3.8 percent. Then it increased again as the system became a bit more generous until a center-right government tightened the rules in 2008. In 2020, the proportion claiming sick leave benefits was back to 3.8 percent (Torstensson, 2022).

Today if an employee is sick the employer pays the sickness benefit for the first 14 days. If a worker is sick for more than a week, they have to submit a doctor's note. After 14 days, the worker applies for benefits from the Swedish Social Insurance Agency. The benefit is almost 80 percent of the worker's income (80 multiplied by 0.97), up to SEK725 per day.

Activity compensation is a form of disability compensation available for workers under the age of 30 whose work capacity is reduced by 25 percent or more due to an illness or disability. Compensation is provided for one to three years based on the extent of the disability and is 64.7 percent of the worker's previous income (up to SEK19,531 a month in 2022). If the person had no income the compensation is around SEK10,000 a month, paid for from general taxation. For those older than 30, there is no activity compensation, and they have to rely on normal sick-leave benefits.

### ***Family benefits***

Sweden has been called a "paradise for families" (Sundelin, 2008, February 18), and its welfare state is indeed very generous to families with children. A Swedish gay writer once calculated that if adults without children did not have to pay for all the special support parents received (schools not included), the typical childless Swedish adult would get an income tax reduction of around one third (Swartz, 1999).

There are many different benefits for families on different levels. There is a universal, non-means-tested child allowance to parents at SEK1,250 a month. This is paid

automatically from one month after a child's birth until they are 16. In 2019, the total cost of the program was SEK29.2 billion. If a child between the ages of 16 and 20 enrolls in full-time secondary education, the parents receive an extended child allowance of the same amount.

There are also increasing returns the more children a family has. A large family supplement is added on top of these allowances for larger families. Parents are paid another SEK150 a month for the second child, SEK580 for the third child, SEK1,010 for the fourth child, and SEK1,250 for any subsequent children. In 2019, the Swedish government spent SEK3.7 billion on supplement payments.

Pregnant women are entitled to maternity cash benefits for a period of 50 days prior to birth, equivalent to 80 percent of the salary they earned before going on maternity leave (up to SEK754 a day). After birth, both parents are entitled to a total of 480 days of paid parental leave to stay home and take care of the child (240 days per parent). A parent can transfer up to 150 days to the other parent, but 90 days are reserved for each to encourage fathers to spend more time with their young children. For the first 390 days of parental leave, the compensation is approximately 80 percent of a worker's income (up to SEK725 a day). For the remaining 90 days the benefit is SEK180 a day.

The government also compensates parents who have to take time off work to care for a sick child. The benefit is similar to the sickness benefit.

Sweden has a means-tested housing allowance for lower-income families to assist with their cost of living. Childless individuals must have an annual income below SEK86,720 to be eligible and married couples an income below SEK103,720. Housing allowances can be up to SEK1,300 per month and vary depending on the surface area of the household, housing expenses, and number of children.

One traditional argument for child-related benefits is that they might encourage a higher birth rate. In a representative article in the *New York Times*, Elizabeth Bruenig writes that the US should imitate Nordic parental benefits to increase the birth rate, but as she admits later in the article (within brackets): “Nordic welfare wonderlands still sport uninspiring birthrates” (Bruenig, 2021, May 7). Between 1970 and 2020, the total fertility rate in Sweden declined from 1.94 to 1.66 children per woman, almost the same as the United States (after it declined there recently) at 1.64. This is slightly above the OECD average of 1.59, but fairly normal for a Western European country and surprisingly low considering large immigration, which is usually associated with high fertility in the first generation (OECD, 2023e). Swedish women born in another country have a fertility rate above the replacement rate (Statistikmyndigheten, 2018).

### **Social assistance**

Individuals who are unable to satisfy their basic needs and are not eligible for other social benefits, like pension, unemployment benefits, or parental leave, can receive temporary

social assistance from the municipality in which they live. Support is means-tested and only provided as a last resort. People have to exhaust bank savings and other assets before being able to receive any social assistance.

The assistance is based on a national norm, set annually by the government for the expected cost of things like food, clothes, health care, and telephone service. It also covers reasonable expenses that are dependent on where and how one lives, like housing, electricity, and insurance. The assistance takes into account the number of family members and the age of any children.

In 2021, eligible single and childless adults were paid SEK4,180 per month and childless couples could receive SEK6,830 per month. If there are 2 parents and 2 children (aged 7 and 12), the basic payment was equal to SEK13,890 a month, while parents with 4 children aged 1, 3, 5, and 15 were eligible to receive SEK18,820 per month due to their larger family size.

### ***Disability benefits***

In 1994 the center-right government established the right to personal assistance for severely disabled individuals who require help to perform everyday activities. Until then, any assistance was given by the municipality in its terms, mostly in the home, and when and by whom it decided; the individual had no say in the matter. The 1994 reform instituted far-reaching legal rights that aimed to help the disabled live and function independently, to “live as others do.”

When someone has been granted a certain number of hours per week of personal assistance, they are allotted SEK304 per hour to pay for that help. They can hire an assistant or buy the service from the municipality, a private company, or a cooperative. The private sector provides around three-quarters of the assistance bought. If the individual needs less than 20 hours of assistance weekly municipalities fund this program from local income tax revenues; the national government steps in if the necessary assistance exceeds 20 hours a week.

This area of government has expanded quickly since 1994, partly because much work that used to be unpaid and performed by relatives is now being compensated. The number of people who receive assistance increased by 142 percent between 1994 and 2017 and the number of hours of assistance per person has almost doubled. In total, the cost has increased from 0.1 percent of Sweden’s GDP to 0.6 percent (Blix and Jordahl, 2021: 86-90).

The increase in the cost of disability benefits is the result of defining a broad yet vague legal welfare right (what does it mean to “live as others do”?) in combination with private providers who have both an incentive to offer more hours to the individual and expert knowledge about the system to convince authorities that it is really needed. Therefore, it is an example of how privatization within the welfare state can increase costs rather

than keep them down. The Swedish Social Insurance Agency has repeatedly warned about excessive use and fraud in a sector that is difficult to investigate (Begler, 2015, September 30). At the same time, it is wildly popular among users who were previously dependent on the whims of bureaucrats or the kindness of family members.

Additional cost allowances can be paid to disabled persons who face additional annual costs totaling a minimum of SEK11,825. In 2020, the additional cost allowance was equivalent to between SEK1,183 and SEK2,713 per month depending on the level of expenses. There is also a car allowance available for those who need to purchase or modify a vehicle to suit their needs, and allowances for assistive devices for those who require special equipment to work.

## Summary

Since the 1970s, Sweden's welfare state has been known globally for its generosity, especially to families with children, but it is often misunderstood. It is frequently presented as a set of uniform, national, single-payer systems where the rich fund the government services and income support for the rest. However, most of the redistribution in Sweden takes place over an individual's life cycle. People pay taxes during their working life and receive benefits and services when they are young, old, or sick. At times, however, transfer programs have become so generous that they have threatened both labour participation and fiscal stability, and they have had to be scaled back. This is an ongoing process.

Most of the services are administered at the municipal or regional level and are mostly funded through flat local income taxes. Unlike most European countries, unemployment insurance is not compulsory and old-age pensions have been reformed from a system of defined benefits to one of defined contributions. The pension system also includes individual accounts, where Swedes invest in funds of their own choosing and eventually receive benefits according to the yields on their individual investments.

Furthermore, since the early 1990s, Sweden has led the world in the privatization of welfare services. Voucher systems and freedom-of-choice laws have established rights for individuals to choose from different providers of elderly care, health care, preschool, and education, in order to encourage individual choice, innovation, efficiency, and availability. In 2017, the private sector provided 17 percent of tax-funded services. The inclusion of the private sector has made it possible for Sweden to deliver generous services while keeping down costs.

With these innovative reforms, Sweden is testing how far a country can go in encouraging entrepreneurship and competition within a tax-funded welfare state. The result is a combination that has sometimes been described as a "neoliberal experiment."





## CONCLUSION

For half a century, Sweden has been associated with socialism. When asked to give an example of a successful socialist country, advocates of socialism often mention Sweden. This image of Sweden became fashionable in the 1970s, but it is outdated. That was in fact the only period during which Sweden ever experimented with socialism, and it was a very short-lived experiment.

Until then, Sweden's economy had been one of the most open in the world. After a classical liberal reform period in the mid-19th century, Sweden had firmly established a system of limited government, free enterprise, free trade, and low taxes. This facilitated the country's rapid industrialization and the growth of major multinational businesses. For a century Sweden had one of the fastest growth rates in the world, and it turned a very poor country into the envy of the world.

As early as 1950, Sweden was the fourth richest country in the world, and it was also one of the economically freest, with government spending below 20 percent of GDP. Sweden's government was smaller than that of other Western European countries, and its taxes were slightly lower than in the United States.

Only after Sweden was one of the world's richest countries did it begin to turn towards socialism. The country's prosperity was not a result of big government and large-scale redistributive policies; its prosperity was the underlying condition that made politicians think that they could safely experiment with generous government spending policies. From 1965 to 1985, public spending as a share of the economy more than doubled from 25.5 percent to 58.5 percent. Taxes surged, businesses were regulated, and ideas about nationalizing big business were seriously considered.

This was the period when Sweden got its reputation for being a socialist economy. It was not an entirely undeserved reputation (even though the means of production were never taken over by the government). But this was also the one period in Sweden's modern economic history when its economy was faltering and growth lagged behind that of other countries.

In this period Sweden became one of the world's most equal economies, not by raising the incomes of the less well off, but by destroying incentives to work and take risks, thereby discouraging entrepreneurs and owners of capital from accumulating wealth. No new major businesses were created from the mid-'60s to the mid-'80s and some of the most successful entrepreneurs and companies, like IKEA and Tetra Pak, left Sweden. Not a single net job was created in the private sector, and the purchasing power of ordinary Swedes

was undermined. Only increased debt and high inflation allowed the experiment to go on as long as it did. Sweden ran deficits every year from 1970 to 1987, and public debt as a share of GDP increased from less than 18 percent in 1970 to over 70 percent in 1985.

Eventually, the Social Democratic Minister of Finance, Kjell-Olof Feldt, would admit: “Afterwards, I had good reason to ask myself how I could have contributed to the Social Democrats going to the polls [in 1988] on a political program that was in fact unsustainable, economically speaking.”

This extraordinary experiment, unprecedented in Swedish history, ended in a devastating financial crash in the early 1990s. For a while it looked as if Sweden was facing the prospect of being shut out of debt markets, and for a short period of time the central bank had to impose a 500 percent interest rate to defend the currency.

When a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully, as Samuel Johnson once put it. This crisis focused the minds of Swedish politicians. The main political forces on both the left and the right agreed that major changes to the Swedish economy had to be undertaken to return the country to an open, growth-oriented economic model. What followed was an intense period of reform and liberalization. Public spending was reduced, and fiscal rules that lowered debt were introduced. Taxes were cut and abolished entirely on wealth, gifts, and inheritances. Business sectors were deregulated, government-owned enterprises privatized, and social security reformed.

Sweden also became a pioneer in privatizing welfare services, giving citizens the freedom to choose private providers, including for-profit businesses, of elder care, health care, preschool, and education. Most notably, Sweden introduced a national school voucher system. The private sector now provides around a fifth of all tax-funded welfare services.

Sweden’s present level of social spending does not make it an outlier anymore; instead it spends like a normal western European economy. This also means that its welfare state is larger than in the United States and other Anglo-Saxon countries. It is not, however, a welfare state that is paid for by the rich, as some foreign admirers assume. Sweden learned in the 1970s that a universal welfare state has to rely on universal sources of funding. Any attempt to get businesses and high-income earners to pay for the bulk of publicly funded social services drains the pool of future businesses and high-income earners, thereby reducing tax revenue.

The Swedish welfare state mostly redistributes income over an individual’s life cycle rather than between groups. Therefore, taxes on low- and middle-income households are relatively high and much of the government’s revenue come from taxes on consumption. This makes Sweden’s tax system one of the *least* progressive in the OECD. The government provides Swedes with generous social services, but to a large extent, recipients pay for those services themselves.

Since the reforms of the 1990s, Sweden’s economy is in many ways more open and market-oriented than other rich countries, and it has once again economically outperformed

comparable countries. New international businesses have proliferated and real incomes have increased relatively quickly following the end of the big government era and the stagnation it brought.

Despite what many outside the country think, Sweden's experiment with socialism in the 1970s and 1980s increasingly looks like a two-decade aberration in what is otherwise more than 150 years of embracing and prospering from a capitalist-inclined economy and open, competitive markets.



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