Sweden's shifting economic model

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Summary

While industry is in decline in most developed countries, Germany is generally held up as an example for its excellent performance (Hénard, 2012). Yet another country, Sweden, seems to be doing better still. Over the last twenty years, both of these countries have succeeded in keeping hold of more of their industrial base than their European neighbours and in maintaining very positive trade balances. Sweden has cleaned up its public finances, which are currently in structural surplus, and has significantly reduced its debt, while maintaining a high level of public services and social protection. La Fabrique de l'Industrie decided to look into the reasons for the success of the Swedish model.

An economy supported by the impetus of major export groups

Today, Sweden exhibits highly enviable performance in terms of competitiveness, growth, GDP per capita, innovation, trade surplus and public finance management.

The country ranks ahead of Germany on all of these criteria, and is only slightly behind it in terms of industry's share of GDP (22.4% in Germany compared to 19.3% in Sweden and 12.5% in France in 2009). From 1995 to 2007, the increase in added value in Sweden was eight points higher than its rate in the European Union. Note, however, that employment growth was nine points lower – the price of significant productivity gains made by Sweden in all sectors of activity, especially market and non-market services.

For industry, productivity gains were made possible in particular thanks to investment in ITC, research and development, and more broadly in immaterial capital. Sweden makes one of the biggest R&D efforts in the world (expressed as a % of GDP), due to private investment. In almost all industrial sectors – both low tech and high tech – and market services, technological intensity[1] is higher in Sweden than it is in the rest of Europe.

The Swedish industrial base is dominated by major groups, most of which are controlled by big families that have built up capitalistic empires. These groups play a significant role in boosting exports. The structure of the Swedish industry, in terms of company size distribution, resembles that of France. Sweden is no better suited to developing start-ups or

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[1] Ratio of R&D expenditure on added value

even medium-sized industries than France; this clearly shows that strong economic development can have different characteristics than the German and American examples.

Does this impressive performance carry any hidden costs? It means making choices, in any case. From 1950 to 1990, growth was a little less high in Sweden than in the rest of the OECD. The country, which in the 1950s was very rich in relation to its neighbours and its own past, focused its efforts into building an equalitarian society while gradually losing its leading position in terms of GDP per capita.

Progressivism: costly but long lasting and consensual

A number of different explanations of the Swedish success story have been put forward. Some esteem that the country has explored a third way between liberal capitalism and communism, leading in the early 1970s to a rich, equal society, cumulating one of the highest GDPs per capita in the world, with a very high level of social welfare and public service, at a time when the rest of the world thought that they had to choose between either greater wealth accompanied by significant inequalities (which were however being absorbed during the three decades of prosperity that followed the Second World War), or equality in poverty. For others, the Swedish model of 1945-1975 led to the inefficient hypertrophy of an over-protective state, a deadlock made apparent by the crisis of the early 1990s, when the country was forced to embark on very intense liberal-style reforms (deregulation, privatization, decentralization) that enabled it to regain its performance.

These two explanations each contain their share of truth. Sweden's path has included contradictory impetuses, crises and accidents. Its highly educated population, which is a little less than that of the Paris region, faced up to these difficulties, entered into debate and looked for consensus to change the direction of its policies, sometimes to a considerable extent. The Swedes are strongly attached (or at least have been since 1940) to their welfare system and public services that pay for citizens "from womb to tomb", to equal access to education, healthcare, and opportunities for socio-professional promotion. At the risk of making an outrageous simplification, we could say that Sweden started by setting up, from 1940 to the 1980s, an efficient, generous but very expensive welfare and public service system, and has since been working at reducing its cost while preserving its core benefits. Even though the system is currently a little less generous than it was in the 1970s, it is still one of highest-ranking in the west and its transparent, well-managed cost is generally accepted by society.

Social dialogue and employment policy aimed at competitiveness and reducing inequality

In 1938, after a period of violent strikes, the workers' and employers' unions signed the Saltsjöbaden Agreement. Centralized negotiations, dominated by highly representative unions, then made it possible to establish salaries and ensure social harmony, by looking for the best acceptable compromise between individuals' welfare and companies' competitiveness, and without any major hitches until the end of the 1960s. The concrete application of the "same job, same wage" principle led to bankruptcy for the least productive companies (who had to pay the same salaries as their most profitable competitors) and encouraged a concentration of companies and a rise in productivity. Active employment policies, combining training, mobility assistance, aid for creating jobs in companies, general interest works and civil service recruitment, enabled the country to maintain its unemployment rate at around 2%. It was during this period that countries like France started to consider Sweden as a “model” country.

In 1969, a particularly tough miners’ strike challenged the representativeness of the only workers’ union and the social democratic party to which it was closely linked. The demand for equality gathered strength, the gaps between salaries became smaller still; performance, levels of responsibilities and education were no longer sufficient for people to earn substantially more. While employment stagnated in the private sector, the full employment policy had the effect of multiplying recruitments in the public sector to the detriment of the economy’s productivity. From 1970 to 1985, the number of civil servants rose from 26% to 38% of the country’s job market.

After several devaluations of the krona, in the 1980s the state embarked on improving public finances. Yet it was not until the 1991 crisis that Sweden decided to put managing inflation above full employment, ten to fifteen years after most other OECD members. The unemployment rate went from 2% to 10% in the space of two years; it currently fluctuates between 6% and 8%. The new national insurance system is less generous, with lower benefits for those who refuse a suitable job. Unemployment is high among young people (20% to 25%, as it has been in France for 10 years, according to Eurostat), but the active employment policy limits long-term unemployment (less than 20% of Swedish unemployed people, compared to 40% in France and the rest of Europe and close to 50% in Germany).

Despite these recent reforms, Sweden is currently one of the most egalitarian countries in the OECD, with the rest of Scandinavia and the Netherlands. Although inequalities have increased since 1970, the ratio between the first and last deciles is 2.79 in Sweden[2], compared to 3.39 in France, 4.21 in the United Kingdom, and 5.91 in the United States (OECD, 2009).

Consensus culture favourable to reform and acceptance of tax in exchange for quality public service

The reason that Sweden is so capable of embarking on deep-seated reforms is because they are always prepared by a long process of expertise and negotiation.

For example, the process leading to the major tax reform in 1991 was initiated by discussions and expert reports as early as 1984. The reform was announced in 1986. Following a summit that gathered all of the party leaders and representatives of major interest groups in October 1989, a consensus was reached on the major lines of the reform. It went forward as planned, despite the government majority changing twice. The pension reform was also subject to preparatory work and a broad consensus. The law was adopted in 1998, with a majority of 75% of Swedish members of parliament, after fifteen years of concerted debate, and despite changes in government.

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[2] That is to say that the minimum income level of the richest decile of the Swedish population is 2.79 times the maximum income level of the poorest decile.

All studies of this country reveal that the Swedes agree to pay higher taxes, convinced that in exchange they benefit from an efficient public service thanks to a highly transparent budget process and monitoring of authorities. The wide-reaching decentralization that started in 1975 and was confirmed by stages handed over management of social services and education to the 290 municipalities, and health and infrastructure to the 20 counties, bringing the decision to make expenditure closer to those that finance it.

Overall, the Swedish tax system weighs less on companies than on individuals, and more on income from work than on income from capital. More precisely, capital income is taxed at a fixed rate of 30%, while work income is subject to a progressive tax, ranging from 30% from almost the first krona to around 55% above a threshold equivalent to € 64,000[3]. In contrast with the common image of a highly redistributive system, Swedish taxes do not therefore aim to remove from people with private means to give to the workers: they ensure that money is circulated in a socially responsible, efficient manner among the population and in particular the middle classes. They largely spare business, only taxing the wealth that companies produce through the income (of work or capital) of those who benefit from it.

Recently, to encourage the energy transition, Sweden set up a green tax system that preserves company competitiveness and is mostly aimed at final consumers. The carbon tax, which is set to increase, represented € 114 per tonne of carbon emitted in 2011 for private individuals. Companies pay 30% of this rate (60% planned for 2015) and most of those that come under the European quota system are exempt. At the same time, decisions have been made to reduce corporate taxes and contributions that still weigh on the labour market to maintain business competitiveness.

In conclusion

A striking number of analogies can be made between the Swedish and French economic models: pre-eminence of major export groups, strong state role, long-standing attachment to redistributing income and public services. However, the two countries are clearly not identical twins. While France struggles to reform, Sweden comes across as an uninhibited social-democracy: it maintains its role as a highly protective welfare state but, when it sees that past recipes are no longer working, it knows how to gather people together beyond their ideological differences and contradictory interests to devise and set up pragmatic structural reforms. This is one of the reasons why understanding the way that Sweden works can shed light on debates for economic reform and industrial competitiveness in France.

[3] In France, this income is in the 30% bracket, or 38% with the CSG (supplementary social security contribution).