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The Swedish Model

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More than just a Saab sister

STOCKHOLM.

Do you think America would be better off with a Swedish-type welfare state? This question tends to evoke strong reactions from both the left and right, yet few understand Sweden's economic history and the revisions it has been making to its welfare-state model in recent years. Sweden was a very poor country for most of the 19th century.

The poverty of those years caused many to emigrate from the country, mostly to the U.S. Upper Midwest. Beginning in the 1870s, Sweden created the conditions for developing a high-growth, free-market economy with a slowly growing government sector. As a result, Sweden for many years had the world's fastest-growing economy, ultimately producing the third-highest per capita income, almost equaling that in the United States by the late 1960s. Sweden became a rich country before becoming a welfare state.

Sweden began its movement toward a welfare state in the 1960s, when its government sector was about equal to that in the United States. However, by the late 1980s, government spending grew from 30 percent of gross domestic product to more than 60 percent of GDP.

Most full-time employees faced marginal tax rates of 65 percent to 75 percent, as contrasted with 40 percent in 1960. Labor-market regulations were introduced to make it very difficult to fire workers. Business profits were taxed heavily, and financial markets were regulated heavily. By 1993, the government budget deficit was 13 percent of GDP and total government debt was about 71 percent of GDP, which led to a rapid fall in the value of the currency and a rise in inflation.

These policies and outcomes greatly diminished the incentives to work, save and invest. Economic growth slowed to a crawl. Other countries that avoided the excess spending, taxing and regulation of Sweden grew more rapidly, leaving Sweden in the dust. Sweden is still a prosperous country, but far from the top, and its per capita income has fallen to just about 80 percent of that in the United States.

Sweden vs. the U.S.

	Sweden	**U.S.**
GDP Per Capita (PPP basis, U.S. Dollars):		
1970	4,610	4,998
2007	36,603	45,489
2008 Economic Freedom of the World Ranking	34	10
2009 Total Government Spending as a Percent of GDP	51.4	45.2
Total Government Debt as a Percent of GDP:		
1993	71.0	49.4
2007	40.5	36.9

2010	49.2	60.1
Budget Deficit:		
1993	13.0	3.8
2009	4.7	13.7
Maximum Marginal Personal Tax Rate:		
2008	57%	35% to 46%*
2011 (proposed)		46% to 58%*
Corporate Tax Rate (2009)	26.3%	39.1%

*The lower rate refers only to federal rate, the higher rate reflects addition of state income taxes for those states that have income taxes

In the late 1980s and 1990s, Sweden began an economic course correction that continues today. Marginal tax rates were reduced for most of the population, and this trend is expected to continue.

The wealth tax and inheritance tax were abolished. Financial markets, telecommunications, electricity, road transport, taxis and other activities were deregulated. Privatization of industry was begun, and the current government is continuing the process. The generosity of some welfare and other benefits has been reduced, with the goal of making work more economically rewarding relative to government benefits. Also, trade liberalization has been expanded greatly. The result has been a pickup in economic growth, and Sweden is no longer falling further behind other developed countries.

One notable success has been pension reform. Sweden was the first nation to implement a mandatory government retirement system for all its citizens. Sweden, like the United States and most other countries, was faced with an increasing, unfunded social security liability as a result of low birthrates and people living much longer. After studying the problem in the early 1990s, the Swedes approved, in 1998, moving toward a Chilean private pension system, first developed by former Chilean Labor Minister Jose Pinera. (Seventeen countries have adopted variations of the Pinerian system, which has been very successful in Chile.)

The new Swedish pension system has four key features, including partial privatization, individual accounts, a safety net to protect the poor and a transition to protect retirees and older workers. The benefits have been substantial budgetary savings, higher retirement income and faster economic growth.

Those who wish to chase the Swedish model need first to decide which model they seek: The high-growth, pre-1960 model; the low-growth model of the 1970s and 1980s; or the reformist, welfare-state model of recent years. The irony is that the current Democratic Congress and administration are rapidly emulating the parts of the Swedish model that proved disastrous and rejecting those parts that are proving to be successful.

Most Swedes now understand that they still have a good distance to go to further strengthen the market economy to ensure continued growth. Thus, they continue to move toward reducing the size of government rather than increasing it.

If the Obama Democrats were wise enough to learn from the Swedes, they would be moving toward trade liberalization rather than away from it. They would be moving to at least partially privatize Social Security. They would not seek to prevent the abolition of the death tax. They would be reducing rather than increasing regulations. They would be reducing rather than trying to increase marginal tax rates on work, saving and investment. They would be reducing the corporate income tax as was done in Sweden.

Finally, the Obama Democrats would be reducing government spending rather than increasing it and not running deficits as large as those that almost sank the Swedish economy 16 years ago.

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