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**Outsiders look enviously at Sweden's economic success. So why are the Swedes thinking of voting out the ruling Social Democrats next weekend?**

FOR much of Europe, the past decade has been depressing. Slow growth, high unemployment and the burdens of rising public debt and falling competitiveness have renewed doubts about the sustainability of the European "social model", which is also starting to creak under the weight of an ageing population. The youthful dynamism of America, and now of China and India, seems to be leaving the decrepit old continent in the shade. Yet there has always been one bright spot amid the gloom: Scandinavia.

In recent years defenders of the European social model—capitalism tempered by a generous and interventionist welfare state—have taken to praising Scandinavia to the skies. The Nordic region, to go a bit wider, has the world's highest taxes and most generous welfare benefits. And yet Sweden, Finland and Denmark (Norway's oil sets it apart) have delivered strong growth and low unemployment, and rank among the world's most competitive economies. Nordic companies are strong in technology and research and development. Their health-care and educational systems are much admired. And, unlike other European countries, most Nordic states run healthy budget and current-account surpluses.

Sweden, whose 9m people make it by some way the biggest Nordic country, is a particular favourite. A year ago the *Guardian*, a British newspaper, said it was the most successful society the world had ever known. As if to bear this out, the Swedish economy grew at a sizzling annual rate of 5.6% in the second quarter of 2006, enough to trigger a spate of interest-rate rises by the central bank. Sweden's big companies, such as Ericsson, SKF, Telia and Volvo, are breaking export records.

A visit to the capital, Stockholm, confirms that life for most Swedes is pretty good. Yet there is disgruntlement in the air, and it is causing nervousness among the Social Democrats, who have ruled Sweden alone or with other parties for 65 of the past 74 years, and must on September 17th again face the voters in a general election. Sweden's Social Democrats are always difficult to defeat: they are well entrenched, well financed and their leader, Goran Persson, who has been prime minister for a decade, is tried and tested. But three years ago Mr Persson lost a referendum on joining the euro and, though the polls show a narrowing gap, most now favour the centre-right opposition, a four-party alliance under Fredrik Reinfeldt, leader of the Moderate Party.

Given Sweden's economic performance, this may seem like rank ingratitude. Many say that it reflects merely

the passage of time. Jan Eliasson, Sweden's impressive foreign minister, notes that "We have been in power a long time. Democratic societies are affected by a desire for change." But critics of the government point to other factors. One is a string of scandals, including several cases of nepotism, that have made the Social Democrats seem a party that has grown arrogant and too accustomed to the perks of government. Another is incompetence, notably the government's slow response to the Asian tsunami of December 2004, in which 543 Swedes died.

But the biggest beef is, perhaps surprisingly, the economy. The opposition maintains that Sweden's economic record is nothing like as good as its fans believe. If so, that has implications for other Nordic economies—and raises doubts about whether other European countries are wise to look northwards for a model.

In truth, the Swedish economy's best years are long gone. Between 1870 and 1950, average growth in Swedish GDP and productivity was, by some measures, the fastest in the world. In 1970 Sweden was the fourth-richest member of the OECD club of industrial countries. But for most of the past 50 years the story has been one of relative decline, including a deep recession in the early 1990s (see chart 1). By 1998 Sweden had fallen to 16th in the OECD rankings. It has since climbed back a bit, but the relatively strong growth of the past decade should be seen mainly as a rebound from the 1990s trough.

For all that, even the opposition accepts that Sweden has some enviable economic advantages. Anders Borg, Mr Reinfeldt's chief economic adviser, praises the country's well-managed, export-driven, high-tech companies and its well-educated workforce. Female participation in the workforce is higher than in most other countries; English is widely spoken; and Swedes are thoroughly computer-literate. Sweden is one of the few rich European countries for which globalisation has been a benefit, not a threat. Most other European governments would be pleased if they could only emulate Sweden's success.



Too few jobs

Set against this are two big weaknesses. The worst is employment. Par Nuder, the finance minister, makes much of Sweden's having the highest employment rate in the European Union after Denmark, at just over 70%. The official unemployment rate is 6%. But Sweden is a world champion at massaging its jobless figures, which exclude those in government make-work programmes, those forced into early retirement and students who would prefer to be working. Sweden's suspiciously large number of workers on long-term sick leave are counted as working, and included in the employment rate (sickness benefits account for 16% of public spending). Absenteeism is common.

Earlier this year the McKinsey Global Institute, a think-tank, studied Sweden's labour market. It found that the rate of employment among working-age people had declined in the past decade. Indeed, Magnus Henrekson of the Research Institute of Industrial Economics says that Sweden has created almost no net private-sector jobs since 1950* (see chart 2). Youth unemployment is among the highest in Europe. The McKinsey boffins conclude that the "true" unemployment rate is around 15-17%, which puts Sweden among the worst job-fillers in the EU. It translates into more than 1m people without work.

The shortage of jobs is felt most acutely by Sweden's fast-growing immigrant population. Thirty years ago Sweden was a largely homogeneous country, but today 10% of its people (and one-seventh of those of working age) are foreign-born. Sweden's new immigrants—especially the country's fast-increasing Muslim population—have integrated poorly compared with the arrivals of the 1970s and 1980s. But the biggest problem for immigrants, as for young Swedes, is work. A study of comparable Somali groups in Sweden and Minnesota found that less than a third of working-age Somalis in Sweden had jobs, half the share in Minnesota.

The result is a worrying new group of excluded people in Swedish society. Mauricio Rojas, who arrived from Chile in 1974 and is now a member of parliament for the (opposition) Liberal Party, says that the number of "excluded areas"—places that are most deprived in terms of jobs, housing, access to transport, protection from crime and so forth—has risen from three in 1990 to 157 now. Most of these areas are heavily populated by immigrants.



Obstacles to job creation are everywhere in Sweden. Although the country's big companies have long thrived, the regulatory and tax climate is chilly to newer and smaller companies. Only one of Sweden's 50 biggest companies was founded after 1970; and Sweden has the lowest rate of self-employment in the OECD. The much-vaunted trilateral partnership between government, employers and unions works if the employer is an established large company; for a new or smaller one, it simply adds to costs. High personal taxes and generous welfare benefits—which pay people who lose their jobs as much as 80% of previous incomes for three

years—discourage work. The “tax wedge” (ie, the non-wage cost of employment) is too thick, especially for low earners.

Above all, the labour market is heavily regulated. The government's labour-market board, once praised for active labour-market policies that got most of the long-term unemployed back into work, now manages to find only one-tenth of the jobs that the unemployed eventually take. Assar Lindbeck, a veteran economist, suggests that the board has become a Social Democratic holy cow that should be slaughtered by any new government.

Although there is no formal minimum wage, Sweden's powerful unions enforce one in practice. The terms of labour contracts are largely set by unions, which dislike temporary or part-time work. In Waxholm, north of Stockholm, the unions managed in 2004-05 to force a Latvian firm that had won a contract to build a school to apply Swedish collective agreements to Latvian workers. The firm went bust—and the flow of cheaper workers from eastern Europe, which Sweden was one of only three EU countries to accept openly in 2004, dried up. In contrast to Denmark's unions (see [article](#)), Sweden's also make it expensive to sack anybody, which discourages hiring.

Too many in the public sector

An overweening public sector has stifled growth in jobs in service industries. Sweden's public sector is, indeed, the economy's second big failing. Mr Nuder asserts that it is no worse than any other, and he claims that the Social Democrats welcome choice in education and health care. Yet Sweden's public sector accounts for 30% of total employment, twice the share in Germany. And, although public-sector productivity figures are unreliable, one recent assessment of efficiency of input use puts Sweden at the bottom of all OECD countries (see chart 3).

It is true, as Mr Nuder says, that Sweden has introduced choice more widely than, say, Britain. Parents can use what are, in effect, taxpayer-financed vouchers at private schools. Private health-care provision is expanding fast. Yet the culture of, to say nothing of the union influence on, the Social Democrats is against competition and private provision of public services. Carl Bildt, who was the Moderate Party prime minister during the recession of the early 1990s, notes that the government now crows about how the huge expansion of privately provided child care has helped to keep up female participation in the workforce. Yet when he pushed through the necessary legislation, it was in the teeth of fierce Social Democratic opposition.

Given Sweden's poor employment record and high taxes, why do so many voters stick with the Social Democrats? One answer, says Mr Lindbeck, is that so many are dependent on the state: some 30% work for it, and a bit over 30% receive transfer payments. Another answer is offered by Mr Rojas. Asked why the opposition's programme is a lot more centrist than it was in 2002, Mr Rojas suggests that a big lesson from the past has been that it is a mistake to attack the government too fiercely, since “all Swedes are to some extent Social Democrats.” An attack on social democracy risks, in other words, being seen as an attack on Sweden itself.



Mr Reinfeldt is now duly cautious. Since his party lost heavily in 2002, he has redefined it, even changing its name to the New Moderate Party. In the past the centre-right has suffered from being split into four warring parties. This time Mr Reinfeldt has got all four to agree to a common programme, and to stick together during the campaign. In contrast, the Social Democrats refuse to deal with the smaller Green and Left parties, which at present back the government but are not part of it. After the election, these parties say they will carry on only in a coalition, which Mr Persson rules out. The uncertainty that hurt the right in the past has been replaced by lack of clarity on the left.

As for policies, the alliance is no longer proposing to slash taxes, nor to dismantle the welfare state. But it is proposing a cut in payroll taxes at the bottom, plus a new working tax credit, both of which should boost jobs. The alliance would pay for this in part by cutting unemployment benefit, from about 80% of previous income to 65%. It also promises further deregulation, especially of services, and more privatisation. Although Sweden's Social Democrats, unlike other left-wing parties in Europe, never nationalised big swathes of industry, the government still has large shareholdings it could sell. And most utilities are publicly owned.

For their part, the Social Democrats' programme amounts to no change. Far from cutting unemployment benefits, the government promises to raise them. As for liberalisation, Mr Nuder says baldly, “We have done enough deregulation.” Indeed, he sees little need for any further economic reforms. To Swedes who have full-time jobs, especially in the public sector, this promise of continuity may seem appealing. To the jobless young and immigrants, it will be less so. These are the groups that, according to the polls, are tilting the election towards Mr Reinfeldt.

In its closing weeks, the election campaign has turned ugly. An outbreak of acerbic name-calling has been aggravated by accusations of hacking and espionage by opposition parties, which led this week to the dramatic resignation of the Liberal Party secretary. This week's debates between the two main leaders on television have

had a new, bitter edge.

That will not bother Mr Reinfeldt so long as he wins, but the opposition could split if he does not. The Social Democrats, too, may face trouble. Whether Mr Persson wins or not, most pundits expect him to step down within a year or two. But since the murder three years ago of Anna Lindh, the foreign minister, he has had no obvious successor. The ruling party is sure to start bickering if it loses next weekend.

Gorgeous, if assembled bit by bit

Where will all this leave the much-trumpeted Swedish model? Most Swedes are weary of listening to foreign claims about the perfection of their society. Mr Lindbeck suggests that, where it does have economic strengths, they are of an essentially Anglo-American, market variety. Johnny Munkhammar, who runs a pro-market think-tank, Timbro, argues similarly that history shows Sweden's economy to have flourished when it has been more liberal and low-tax—and to have gone off the rails when higher taxes and more regulation have been imposed.

The truth is that there is never a single economic model for other countries, even the Nordic states, to follow. Neither membership of the EU nor adoption of the euro seems necessary: Sweden is in the EU but not the euro, Finland is in both, Norway is in neither. Different countries have different strengths. Mr Bildt puts forward his own tongue-in-cheek recipe for the perfect "Nordic model", stretching the geography: Finland's education, Estonia's progressive tax policy, Denmark's labour market, Iceland's entrepreneurship, Sweden's management of big companies and Norway's oil. The right conclusion, in other words, is that it is wisest not to look for a single-country model at all, but just to take best practice wherever you find it.

* "Economic Performance and Work Activity in Sweden after the Crisis of the Early 1990s", by Steven Davis and Magnus Henrekson. NBER papers, forthcoming

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