Lesson 4: The Mirage of Swedish Socialism

Introduction

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 This image of Sweden became fashionable in the 1970s, but it is outdated. In this lesson students learn how before their experiment with socialism in the 1970s and 80s, Sweden was one of the most open economies in the world. Since socialism, they have returned to a very open economy with a large welfare state paid for by the population at large.

Materials

Lesson 4 slide deck:
https://docs.google.com/presentation/d/1-nYvgrnEEqGdKl6y_pd-oi99-cKjxnrs/edit?usp=sharing&ouid=116660462288476410506&rtpof=true&sd=true

Optional: Lesson 4 **Background Information**. 1 copy per student (if assigned as student reading)

Key Terms

Budget Deficit	The situation where expenditures exceed tax revenues.
Budget Surplus	The situations where tax revenues exceed expenditures.
Inflation	A general increase in the price level.
Nationalization	The process of taking private property and transferring ownership to the state.
Public Debt	The total amount owed by the national government to those from whom it has borrowed to finance the accumulated difference between annual budget deficits and annual budget surpluses.
Socialism	A society in which the state controls resources and makes decisions about production and equitable distribution.
Taxes	Payments that individuals and businesses are required to make to local, state, or national governments.

Objectives

Students will be able to

- Identify examples of how entrepreneurship was negatively affected by Sweden's move toward socialism.
- Describe the relationship between the move to socialism and increased budget deficits.
- Explain how a transition back to markets alleviated the Swedish economic crisis.

Time Required
45 minutes

Voluntary National Content Standards in Economics

CONTENT STANDARD 11: Money and Inflation

Money makes it easier to trade, borrow, save, invest, and compare the value of goods and services. The amount of money in the economy affects the overall price level. Inflation is an increase in the overall price level that reduces the value of money.

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- Benchmark 5: In the long-run, inflation results from increases in a nation's money supply that exceed increases in its output of goods and services.

CONTENT STANDARD 14: Entrepreneurship

Entrepreneurs take on the calculated risk of starting new businesses, either by embarking on new ventures similar to existing ones or by introducing new innovations. Entrepreneurial innovation is an important source of economic growth.

- Benchmark 1: Entrepreneurial decisions affect job opportunities.
- Benchmark 2: Entrepreneurial decisions are influenced by tax, regulatory, education, and research support policies.
- Benchmark 3: Productivity and efficiency gains that result from innovative practices of entrepreneurs foster long term economic growth.

CONTENT STANDARD 16: Role of Government and Market Failure

There is an economic role for government in a market economy whenever the benefits of a government policy outweighs its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also have direct or indirect effects on people's incomes.

- Benchmark 9: Governments often redistribute income directly when individuals or interest groups are not satisfied with the income distribution resulting from markets; governments also redistribute income indirectly as side-effects of other government actions that affect prices or output levels for various goods and services.

Procedures

- Prepare by reading the **Background Information** included at the end of this lesson.
- Use the **Lesson 4 slide deck** to teach the key ideas about the socialism experiment in Sweden.
- Alternate Activity: Assign the **Background Information** as a student reading.

Background Information

The following background information is quoted directly from the Fraser Institute publications of "The Mirage of Swedish Socialism" published as a part of the Realities of Socialism materials. For a complete copy of the readings please go to RealitiesofSocialism.org.

INTRODUCTION

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.

In the early 1990s 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.

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. 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.

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. 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.

Poor but free

Sweden was a very poor country of free farms, 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.

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.

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 economic historian Mauricio Rojas has argued that in Swedish 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. In addition, farmers were remarkably literate. Although Sweden introduced mandatory elementary education in 1842, Swedish literacy rates were around 90% as early as 1800. 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. ” (Johansson, 2009: 55f).

It was this paradox, identified by Rojas that caused Sweden to be 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 20th century.

The reform period (1840-1870)

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. 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.

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 liberal era 1870-1970

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.

The liberal era brought significant changes to the economy. The first noticeable change 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. In addition, 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. Sweden was starting to transform itself from an agricultural economy into an urbanized, industrial economy with a growing working class.

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 with limited government. [This model] has produced impressive social and economic outcomes.

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.

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. In 1950, Sweden was the third freest economy in the developed western world, after the United States and Switzerland. 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 unequaled 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.

THE RISE AND DECLINE OF SOCIALISM

Sweden never became a textbook socialist country, with the means of production in government hands. 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. This led to the adoption of a system of tight regulations, price controls, and tax increases that 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.

The Socialist era: 1970-1990

The government policy, influenced by Nils Karleby,, 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. Many Swedish citizens concluded that now the economy could afford a very generous redistribution policy.

Implementing this redistributive policy led to a dramatic growth in government spending and regulation of the economy. In just 20 years, public spending more than doubled, from 25.4 to 58.5 percent of the GDP. between 1965 and 1985. This came primarily from a rapid expansion of social services like health care, elderly care, and childcare, 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. Capital gains were taxed as income, at progressive rates.

At the same time, the Swedish government raised the cost of doing business. In 1970, Sweden introduced an opaque system of price controls, which forced businesses to negotiate price changes with business groups and government authorities. This was followed by abandoning the traditional model of determining labour agreements through negotiations between businesses and trade unions. Instead, the government directly regulated labour protection, greatly reducing the flexibility of companies to manage their workforce.

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. 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.

The oil crisis of 1973-74 revealed a productivity crisis throughout the western world. In Sweden, self-assured politicians, responded by trying to bridge the recession with a massive stimulus program that supported both extra demand and production. 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.

In response to this recession the government doled out massive corporate subsidies to keep workers employed. 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 the government. While under the Swedish government, the steel industry only returned modest profits and was eventual privatization after almost half of the workforce was let go and most of the plants and product lines were eliminated.

During this period 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.

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. 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. High income earners were leaving the country. Astrid Lindgren, author of Pippi Longstocking, described how she was forced to pay taxes in a single year of 102% of her income, effectively causing her to lose money on every krona she earned.

The Crisis (1990-1994)
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 to return to the economic model that had been so successful in the past.

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.

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 founded since 1970 were controlled by the national government or the city of Stockholm.

The third reason was the 1990-94 financial crisis. 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. 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 capitalist welfare state (1995–)
"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.

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. 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 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 childcare, elderly care, and health care started to proliferate.

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. However, Sweden is still a big welfare state; total public spending is around 50 percent of GDP.

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. Now Sweden relies more on consumption taxes and flat payroll and local income taxes than 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.

Conclusion

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, that is not the case. Instead, most Swedes pay high income and sales taxes to support a generous welfare system. 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. 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.

When Sweden is pointed to as a model of a socialist state it should be remembered that the socialist state was an experiment that only lasted for a few years. Sweden for much of its existence prior to and after the experiment with socialism has had a free-market based economy undergirded by private ownership and strong property rights.