

Bucking the Trend?

The Welfare State and the Global Economy:

The Swedish Case Up Close

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Will Globalization Kill the Welfare State?

The conventional globalization thesis predicts that increased factor mobility will reshape political incentives across the world. According to the most dire predictions, capital and labor will flee welfare states in favor of jurisdictions where they will find cheaper employees, less restrictive governmental regulations, and lower taxes. This argument specifically suggests that countries with very heavy tax burdens will be the most vulnerable to the competitive forces in the new global economy. Finally, this theory suggests that political leaders in high tax countries will have no alternative than to reduce tax burdens and ultimately roll back welfare state spending - else they suffer the wrath of profit maximizing investors and alienated voters.¹

The following analysis offers a partial test of these hypotheses through an examination of the politics of taxation and tax reform in the world's most heavily taxed country - Sweden. This paper will demonstrate that over the past 20 years there have indeed been important changes in Swedish taxation policy, and that these changes are systematically connected to changes in political and economic interests, policy ideas and public institutions in Sweden. But the evidence does not support the hypothesis that Sweden has - or is about to - substantially roll back its tax burden and/or its welfare state.

This case study supports other recent analysis which question the globalization and/or convergence hypotheses and instead suggest that there are powerful path dependent reasons for countries to continue pursuing different varieties of capitalism and that while all countries must indeed adapt to the realities of increased factor mobility, this does not necessarily imply that all countries must (or even should) follow the same path.² On the one hand, it appears that the fear

that globalization should create an End of the State is simply wrong. On the other hand, I show that there have indeed been very important changes in what was once called, The Swedish Model and these changes may imply that Sweden is no longer quite as distinctive or unique from other advanced welfare states as it was once thought to be.

In the end, this study suggests neither The End of Redistribution, nor does it support the argument that modern welfare states like Sweden must give up their redistributive ambitions. Instead, it appears that the Swedes are continuing their historical path manipulating some kind of middle ground between the rampant liberalism of free markets and controlled markets in the hands of a large and powerful state. The Swedish welfare state is adapting to the realities of the New Political Economy, but it is not dying because of it.

The Swedish Model

Sweden has held a special place in the academic literature and in the popular imagination for two separate reasons: First, it has often been viewed as the archetypical example of socio - corporatism. Second, it is even more widely known as the country with the most expansive (and expensive) welfare state in the world. I argue that it is important to distinguish the decision making institutions from the size of the welfare state. While these two phenomenon are related (see below) they need to be understood separately particularly if we want to understand modern Swedish political economy. The first should be understood as a *decision making model* the second is a set of *policy outcomes*. This analysis suggests that while important aspects of the corporatist decision making model are no longer viable, the essential features of the Swedish social welfare state as policy outcome is healthy and perhaps even thriving.

This Swedish Model - as decision making model - rested on a particular decision making regime that was first and foremost highly centralized. Representatives from the major union federation (LO), the major employer federation (SAF), and the government - which essentially meant elites from the Social Democratic Party (SAP) - met regularly and consistently to negotiate out major decisions about the future developments in the Swedish political economy.³

This was a profoundly elite driven system. A key feature of this model was the extent to which a quite small group of leaders from the major economic interests in society would sit together and haggle out the economic plan for the country. This often meant that unions would impose wage discipline and that the employer federation (SAF) would agree to national wage bargains that would explicitly undermine many of their constituent members. The Social Democratic government was formally outside the specific annual wage negotiations, but quite clearly the government held both carrots and sticks with which to reward and/or punish the labor market partners. An explicit policy goal of this model was to squeeze labor and capital into the large, export oriented manufacturing industries. At the same time, Sweden maintained an open international trade policy which was explicitly aimed at forcing Swedish firms to maintain international competitiveness. These firms were, of course, precisely the firms dominated by LO unions (Sweden's large centralized union organization) and SAF (Sweden's major employer federation).

Taxation policy was a keystone in the deal between the Social Democrats, organized labor, organized capital. For their part, large export-oriented capital firms would be supported with explicit tax incentives even while Socialists were in power. At the same time labor unions would also be supported and specific wage strategies that would advantage lower paid workers

over higher paid workers would be part of the national wage bargain.⁴ The other side of this corporatist deal was that big unions and a powerful state would also be tolerated, employment would be held at very high levels, and when economic change was called for, the individual worker and his family would be fully compensated for economic costs of structural transformation. Specific policies favoring unions were also introduced⁵ and wide variety of public insurance, education, and welfare programs were established and expanded.

Contrary to many people's understandings, the Swedish corporatist decision making model did not *necessarily* imply a very large welfare state - nor high taxes necessary to finance it. To be sure, welfare state programs were part of the basic compromise between labor capital and the state in Sweden - just as they were in every other advanced capitalist nation. But in the first several decades in which this decision making model was in effect, Sweden did not have a particularly heavy tax burden (See Table 1).

Table 1 about here

It should also be specifically noted - in the context of the current debate about the conflict between redistribution and globalization - that the system of active labor market policies combined with incentives favoring economic dynamism and flexibility in both the corporate sector and amongst workers, could and did contribute to economic growth *and* income equalization. Though it may be impossible to disaggregate the redistributive effects of these labor market institutions from the effects of specific social policies, it is widely recognized that labor market policies were enormously important in creating the egalitarian society for which Sweden became

so famous⁶. Though a few movie producers, popular writers and sport stars left the country due to the onerous tax burden, capitalists and large companies were offered very generous tax expenditures such that they actually paid very little taxes indeed.⁷ Contrary to many people's expectations, it was never true that Sweden used taxes directly to redistribute income between social classes. Quite the contrary, to the extent that the tax system has redistributed income it has been *from wage earners to capitalists*.⁸

Politicization and Decline of the Corporatist Bargain

Perhaps all bubbles must burst. In retrospect it seems that no sooner had Sweden become recognized as the premier example of the Middle Way between the individuating and inequalitarian Capitalism of the West and deadening and inefficient Socialism of the East, than the system began to leak. There is insufficient space in this essay to detail the evolution of the changes in the Swedish political economy from the 1970s through the 1980's but a few general points must be noted so that we may better understand the new context in which tax policy began to turn in the 1980s and 1990s.

The beginning of the end can be traced back to the early 1970's. Certainly the watershed event was a massive wildcat strike beginning in the iron mines in the north of Sweden (Kiruna) in 1969. These strikes were exceptional because they were strikes from the heart of the working class *against the union organization and their political allies in Stockholm*. Though the strike itself was eventually settled in favor of many of the miners' demands, the more basic accusations implied in the strike left serious self-doubt in the minds of the labor movement and 'Socialist' leadership. What kind of union and what kind of Social Democracy is it that workers themselves

feel they must strike against?

These doubts led to significant self-examination and rethinking both within the Party and inside the LO: Unions became less quiescent and began to demand both higher wages from employers in their national wage negotiations *and* more public spending from the Social Democratic government as well as more explicitly redistributive (populist) tax measures. At the same time, the Social Democratic Party itself (at least significant portions of the Left within the Party) came to question their own legitimacy. Several substantial changes grew out of these self-examinations: First, in 1974 the government introduced a constitutional change that was intended to make Swedish democracy more direct and more responsive to citizens.⁹ Second, the LO began to demand structural changes both at the workplace level¹⁰ and later even in terms of the public ownership of Swedish capital.¹¹ Perhaps unsurprisingly, the Swedish Employer Federation (SAF) came to believe that the LO and the Social Democrats could no longer be trusted. At the same time, as Olof Ruin points out, A the parliamentary level the most important development in the 1970's, parallel to the new constitution, was the weakening of the executive as a result, he argues, the government was less able to take unpopular decision, and to distance itself from special interests.¹² Thus, at the same time that trust between the former partners declined,¹³ the ability of the Social Democratic elite (particularly the Ministry of Finance) to act as guardian of the public purse also declined. The result was a dramatic increase in public spending - and the tax burden that was necessary to finance it.

Figure One about here

By the mid-1970's and 80's social benefits and transfers had reached proportions which most non-Swedes, at least, would find quite remarkable indeed.¹⁴ Still, it is critical to understand, that even while the level of benefits etc. offered in the Swedish system were quite high by international standards, the core of this social welfare system was a system of transfers within members of the working and middle classes - not between classes. Even as the size of the welfare state grew, this was not a redistributive tax system in the sense that it took money away from the wealthy capitalists or from corporations and gave it to the poor or the workers. Instead, these huge public expenditures were financed virtually exclusively through taxation on income earners. As Figure 1 above demonstrates, Corporation Profits taxes are not (nor have they ever been) a major source of revenue in Sweden. Even with the massive expansion of tax burdens since 1965, corporate profits tax revenues have been both low and stable. In point of fact, there was a general tax/transfer subsidy from earned income to capital income.... in other words, not only were workers taxed very heavily to pay for the social welfare state programs from which they benefitted, their taxes also directly subsidized the capital sector of the Swedish economy. This was because the tax incentives for capital investment had become so generous in Sweden that capitalists were generally able to take more deductions from capital investment than they would generate in profits.¹⁵

The tax increases indicated in the figure above had significant implications for the Swedish political economy well before the term globalization hit the world stage. Simply put, the high levels of taxation now imposed on wages and consumption placed significant inflationary pressures on the Swedish economy and encouraged Swedish employers to even further internationalize their operations. Economists have long argued that rational employees will

calculate their wage bill in after tax terms. Whether or not this is true in decentralized and low tax countries such as the US, taxes were most certainly a part of the annual wage negotiations in Sweden. By the early 1980's an average industrial worker suffered a marginal income tax of over 50%. This meant, in effect, that if a worker was to receive a real income increase of, say, 10 krona per hour, she needed to get a nominal increase of 20 krona an hour. When we add the employer Social Insurance Charges which reached 36% of the wage bill by the early 1980's, it quickly becomes clear why Swedish workers were being priced out of the international marketplace.

The growth of public programs also expanded the number of public employees. These employees were not traditionally organized by LO unions (who generally represented manufacturing and/or blue collar workers) but were instead organized by either the TCO or by SACO-SR (representing mostly white collar educated professional) unions. The significance of this change is that while Sweden - which had once been noted for its highly centralized wage negotiation system and unified and disciplined union structure - was now developing a substantially fragmented union structure. As unionization expanded, the growth of the public sector meant that working class interests themselves began to diverge. The blunt truth is that it is far easier to find a common front between the interests of miners and auto workers, for example, than it is to find a common interest between medical doctors and day care employees. Ironically, then, a consequence of building a big welfare state was to undermine worker solidarity in Sweden.

These developments had direct consequences for both wage demands and public spending in Sweden. In the old Swedish Model, union wage demands could be tempered by the economic realities of the international marketplace, *and* decisions once reached at the elite level could be

implemented at the local shop floor level due to the high degree of power of the central union organization. But by the late 1970's and early 80's the Swedish political economy was quite different. Whereas unions in export oriented industries had once been willing to practice wage restraint on the logic that their jobs depended on international competition, the newly powerful public employees unions have do not have the international market discipline to temper their demands. By 1989 the TCO and the SACO-SR represented 41.7 percent of the workforce.¹⁶ Given these basic facts, Sweden quickly developed even stronger inflationary proclivities. The government, desperately trying to maintain Swedish international competitiveness, felt that its only alternative was to periodically devalue the Swedish Krona. The result, as Ton Nottermans has argued, was that [t]he Swedish Model collapsed when, due largely to internal pressures, employers and unions had become unable to deliver any kind of wage moderation.¹⁷

In sum, by the late 1970s and early 1980s, Sweden was in a process of undergoing substantial changes in both her political decision making institutions and in her economic structure (upon which the political institutions in many ways depended). These changes were partially a result of the internationalization of the world economy (ie. the maturation of world capitalism) but it is incorrect to pin these problems/changes on the far more recent changes commonly referred to as globalization. Long before this term was even coined in the popular media, the Swedish Model was already crumbling.

Tax Reform: A Conspiracy of Elites?

By the early 1980s, many members of the Swedish economic elite - both within the Ministry of Finance and in the economic profession more generally - saw these developments as a

crisis. The crisis, was both economic/fiscal and a crisis of confidence. Whereas in the past these elites believed they could manage their economy quite effectively, now they were increasingly convinced that such management was no longer possible. What were once thought of as labor market partners were now simply Interest Groups. In addition, whereas the political system in the earlier era insulated the fiscal elite and gave them enormous policy autonomy, now political demands on both tax and spending side were increasingly difficult to shut out. In the words of one senior Ministry of Finance official, I was taught in college that we could manage the economy via fiscal manipulations. But now in Sweden, and other countries too, we have less faith in politicians. We now realize that political asymmetries are so large that you have to be careful about what you recommend. Politicians don't only do what their economic advisors recommend, they also have to listen to interest groups..... If economists think that political decisions are symmetric, then they use false assumptions. Politicians have short time horizons.¹⁸

At about this time, (early 1980s) the Minister of Finance, Kjell Olof Feldt, began to seriously question the long term viability of the tax system that was evolving. In his view, the system of high marginal tax rates, effectively reduced by deep tax expenditures (loopholes) was creating a system of false economic incentives and at the same time undermining Swedish citizen's basic belief in the 'fairness' of the tax system.¹⁹ The Ministry had a substantial problem, however: The majority of Social Democrats in the Riksdag (Parliament) as well as the leadership of the LO did not agree with Feldt's diagnosis of the Swedish tax system. Quite the contrary, most SAP politicians shared the general perspective of Swedish citizens who believed that the problem with the Swedish tax system was that the rich and the corporations paid too little in taxes, while the lower and middle classes paid too much.²⁰

For the bulk of the 1980's tax and tax policy stood at the center of the enormous political battle inside the SAP. In some ways, this battle could be understood as an ideological campaign for the very meaning of Social Democracy in Sweden. The struggle is better understood, in this author's view, as a fight over the *means of achieving* the basic goals of an egalitarian social democratic society. This was a battle over *ideas* not *values*.²¹ The critical issue for the Ministry of Finance was what kinds of public policies will allow Sweden to continue to compete and succeed in the world economy in order that the economy could provide sufficient economic well being to be distributed amongst its citizens.

In a recent interview Mr. Feldt, recalled his views as follows: The negative inheritance I received from my predecessor Gunnar Sträng (Minister of Finance 1955 - 1976) was a strongly progressive tax system with high marginal taxes. This was supposed to bring about a just and equal society. But I eventually came to the opinion that it simply didn't work out that way he concluded. [Progressive] taxes created instead a society of wranglers, cheaters, peculiar manipulations, false ambitions and new injustices. It took me at least a decade to get a part of the party to see this.²²

Swedish economists were also turning against the traditional high tax rate/deep tax expenditure system that Sweden had developed in the post-war years and were producing a steady stream of reports demonstrating the economic inefficiencies and redistributive inequities of the extant tax system.²³ Of course there was some variation in arguments and nuance, but during the 1980's it became virtually conventional wisdom amongst the economic elite both inside and outside government that the structure of the tax system was by now creating far too many problems for the economy.²⁴ Even the senior LO's economists, were finally overwhelmed by this

consensus. When asked what brought him to change his opposition to reducing top marginal tax rates in Sweden one senior LO economist responded rather curiously, We believe what we believe because others believe it. When asked to elaborate, he explained that he came to understand that he was way out of the elite consensus on these issues by the late 1980's and was advised by a close friend and colleague that People aren't taking you seriously anymore.²⁵

Throughout the 1980s, then, the Ministry slowly but surely chipped away at the tax system that had been built up over the past 40 years. By the end of the decade the Socialists had passed a series of tax reforms which simplified the tax code, lowered marginal tax rates, increased consumption taxes and scaled back a series of tax expenditures. For example, the top marginal tax rate on income at the national level was reduced from 58% in 1980, to 50% in 1985, to 45 % in 1988 and 35% in 1990.²⁶

The Tax Reform of the Century

The internal fighting within the Social Democratic Party in Sweden eventually led to a crisis of confidence among voters. The Left in the party was increasingly alienated and suspicious of the Ministry of Finance in general and the Minister of Finance Kjell-Olof Feldt in specific. At the same time, the more centrist voters feared the growing vociferousness and bitterness within the party implied a return to the more traditional Leftist policies of the earlier years. The result, unsurprisingly, was that the Social Democrats were turned out of office just as they were putting the final touches on what they hoped would be the crowning of their incremental reforms into The Tax Reform of the Century.

The new government, a center-right coalition between Conservatives, Liberals and the

Center Party was easily persuaded to continue the tax reform agenda. The key problem, however, was that each of the coalition partners also wanted to cut taxes for their particular constituencies. The end result was still a quite fundamental tax reform.... but Ministry of Finance officials (most of which were still left over from Feldt's regime) could not hold the fiscal line. As a result, contrary to the original plan, the reform was underfinanced.²⁷ Still, with this reform Sweden took a huge step away from very high marginal rates, to a much broader based tax system. The top marginal income tax rate was reduced to just 50% in 1991.²⁸ These rate reductions were financed largely through base broadening measures.²⁹ Perhaps most importantly, the deductibility of interest payments from the national income tax. Capital taxation was also radically reformed: All capital income now faced a flat 30% rate while deductions were substantially rolled back.³⁰ The Corporate Profits Tax was also reformed: The marginal corporate profits tax rate was reduced from 57% and now brought into alignment with the capital income tax rate of 30% at the same time that many of the most generous tax expenditures available in the code were eliminated.³¹ Finally, a series of other rather specific reforms and adjustments were instituted (such as taxing the percent return on assets in private life insurance and pension funds) which were designed to either balance the negative redistributive effects of rate reductions, close specific loopholes, and/or to raise revenue.³²

Effects of Tax Reform

When the Swedish tax reform of 1991 was finally introduced by the bourgeois coalition government many analysts saw this as the beginning of the end of the Swedish Welfare State. Though tax burden remained quite high to be sure, gone was the public commitment to maintain a

(nominally) progressive tax system. Moreover, since the tax reform was underfinanced, many analysts (including this author) assumed that the lost revenues would eventually have to be made up with increases in taxes on lower income earners, or cuts in benefits for lower income earners, or both. These predictions of course fit very well with the analysis *End of the Welfare State* analyses which became so popular in the mid-1990's.

The evidence pointing in this direction was aided by the fact that the tax reform also contributed to the massive economic crisis which struck Sweden in the early 1990's. It was once again the bourgeois coalition government's bad timing to come to office at the beginning of a recession (as they did in 1976), but clearly the policies pursued by this coalition government (i.e. with each party trying to pay off its particular constituency) substantially worsened Sweden's economic situation. The tax reform, for example, dramatically exacerbated the collapse in the real property market.³³

In the face of this economic disaster, the government found itself politically incapable of cutting housing support, child payments, social welfare payments, sickness benefits or any other major social program in the context of an economic decline of this magnitude. In fact, these years actually witnessed an *increase* in public spending despite the fact that the bourgeois government was at the helm. The result was that the budget deficit increased to 13% of GDP. At one point international confidence in the krona sunk so low that the central bank was forced to increase the overnight lending rate to 500% in a vain effort to protect the currency.

Not only was *Swedish Model* was apparently dead, it now appeared that the Swedish economy was lying on the deathbed next to it.

The Socialists(?) Return

Perhaps unsurprisingly, the dire economic performance of the early 1990s soon brought the Social Democratic Party (in coalition with the Left Party³⁴ and the Green Party) back to office (1994). Sweden's unofficial Party of Government quickly set about restabilizing Sweden's financial picture. At first it appeared that the Socialists had accepted the basic TINA logic as they began cutting back several social welfare policies. But careful analysis of these policies suggests that rather than slash programs wholesale, most of these reductions were in fact designed to make them more fiscally reasonable and remove some of the opportunities for abuse that had been created earlier by the stunning generosity of these policies.³⁵

But the new government did not accept the idea that it must redistribute wealth upward. Instead, the government initiated several studies which examined the consequences of the tax reform after the behavioral changes it created had been considered. These studies revealed that the 'Tax Reform of the Century' as finally introduced was indeed regressive. Armed with this evidence the government increased the top marginal rate of tax on very high income earners by 5% and the following year reduced the VAT rate on food by 50%. In addition to changes in tax rates, the government has continued to put pressure on tax expenditures of various kinds. These multiple changes are far too many and detailed to discuss in this paper, but it is important to note that tax revenues have increased rather than fallen as a result of the tax changes imposed by the Social Democrats after they returned to office.³⁶ According to the OECD, revenue increases from cutting back on tax expenditures for capital income alone yielded the government 60.4 billion krona in 1995 and another 35.1 billion krona by 1999.³⁷

The Buoyant Social Welfare State

Perhaps surprisingly, (at least to those ideologically committed to the idea of a small state) these tax increases did not choke off Sweden's economic recovery. By decade's end, Sweden's economic and fiscal picture had instead improved markedly: Unemployment had been reduced (though not to the levels common during the heyday of the Swedish Model). The budget was now in surplus. Investment has returned to levels not seen in many years. (See Table 2)³⁸ Finally, GDP growth was now at a healthy and sustainable rate. Indeed, the first budget in the new century was widely heralded (and decried) as, *A Classic Social Democratic Budget*.³⁹

Table 2 about here

Instead of using the budget surpluses to cut taxes on mobile capital as was demanded by the right and predicted by many analysts, the Finance Minister has chosen to *increase* public spending on child support yet again and to continue using the surplus to paying off Sweden's substantial public debt. As the following table indicates, (Table 3 below) the government does not envision scaling back on the state anytime soon. If anything, the picture drawn by the government with their own pen is one of continuing high taxes as well as high social welfare expenditures. As one Ministry of Finance official told this author *We love Sweden the way it is. That may be difficult to sell politically, but it is the simple truth. We think things are pretty good here and we want to keep them that way. Of course we want to keep up with and stay ahead of changes in the world economy, but we see no reason why we should have to cut back tremendously on taxes or spending at this point.*⁴⁰

Table 3 about here

Most non-Swedes find it surprising that Swedes did not revolt against their tax burden long before it reached 60% of GDP. Few non-Swedes can understand how and why a people could tolerate paying over half of their income to the tax authorities. But what we (non-Swedes) fail to understand is that most Swedes clearly believe they get a lot for the high taxes they pay. Survey after survey has shown that while Swedes (like virtually all citizens in modern welfare states) agree that taxes are too high, only a minority of citizens support tax cuts if they are forced to choose them in exchange for reductions in public spending.

It is also difficult to overemphasize the political implications of the fact that today at least 65% of Swedes receive a direct public subsidy from their government.⁴¹ Thus to *average* Swedes, cutting back on public spending means cutting back on benefits they directly receive from the government. Swedes clearly believe that they get much for their tax krona and as a consequence there is very little public pressure to cut taxes even though tax burdens were so high.⁴² Moreover, in many areas at least, they are actually willing to pay more (see Table 4).

Table 4 about here

The political consequences of these voter preferences are exactly the opposite of what the globalists once predicted: Today the major political challenge facing the Social Democrats is not from the Right, but instead from the political Left. Not only is the Liberal Party teetering close to 4% electoral margin⁴³ the Center Party (former Agrarians) has taken an increasingly leftist/green

position while the former Communists (now Left Party) is gaining significant ground on the Social Democrats and even threatens to become the second largest party in the parliament. The combination of these electoral pressures on the one hand, and the SAP elite's public commitment to continuing and improving welfare state programs on the other, the Social Democrats appear in no danger of giving up their egalitarian values. According to some sources in the government, there is still pressure to use budget surpluses to reduce taxes on particularly mobile financial assets such as financial capital. But they have also clearly committed to use future budget growth to subsidize families, and continue to pay down the Swedish debt. Moreover, given the potent economic performance Sweden is now posting, combined with the daily discussions of the herds of new Internet millionaires in Swedish media, there appears to be little political incentive to cut these people's taxes - certainly not taxes on high income earners. Instead, the central political debate as the country enters the next century appears instead to focus on how to spread the new wealth so that even those currently left behind will be able to benefit from the current economic boom and on how to best shore up lagging public services - especially in the health sector.

The Swedish Model vs. The Social Welfare State

The Swedish Model (ie. corporatist decision making institutions, solidaristic wage policies, and perhaps even the Politics of Compromise) may now well be dead. But, the ambition and the political support for a largely egalitarian polity with a very large welfare state (and the taxes to support it) live on quite healthily in Sweden today. The Swedish Model as decision making system was an historically bounded institutional setup. It did, however, enable the construction of a kind of social welfare state that now has its own political force. In short,

though the Model may be dead, its legacy is quite alive and well.

Clearly, the Social Democratic elite in Sweden has changed its ideas about how to achieve the goals to which the party has long been committed. But there is little evidence to suggest that this elite has changed its values with respect to an largely egalitarian society, a large distributive welfare state and a successful capitalist economy. The Swedish Social Democratic Party elite has never been socialist in the traditional 'anti-capitalist' sense of the term.⁴⁴

Capital *is* more mobile internationally today than it was three and four decades ago. This is a basic fact within which the Social Democrats must work. They have, for example, virtually conceded that they will not be able to tax mobile financial wealth in the age of the Internet economy. Thus, the expectation is that capital taxes will continue to be driven down. But as Swedish Ministry of Finance officials are quick to point out, and as this essay has attempted to demonstrate, capital taxation has never been an important source of revenue nor of redistributive policy in Sweden.

Whereas only a few years ago a large number of popular reports predicted that the high tax rates and overall tax burdens in Sweden would drive high income earners and capitalists out of Sweden, today these same publications announce the rebirth of the Swedish economy and sometimes curiously ponder why capitalists aren't rational actors (ie. Why don't they follow their 'rational self-interest' and abandon this high tax country?).⁴⁵ What this kind of analysis simply forgets is that a strong social welfare state, like the Swedish, helps finance for a quality of life that low individual taxes cannot easily buy. High income Swedes are well aware of this choice. For example when faced with the question, Why don't you leave? Certainly, you would pay a lot lower taxes and probably also have a higher salary in the U.S. a Volvo executive responded as

follows: Yes, of course, I would have a lot more money in my pocket. But I would also almost never get home before 7 o'clock and I certainly would not have the vacations everyone has a right to here... and you know what else, I would have to spend a lot more money on insurance, college for my kids, and travel back home to my family. In the end, I'm not really sure I would be any better off.⁴⁶ Recent analysis of migration patterns of highly educated Swedish workers conducted 'in house' by the government suggests that though a large number of Swedish engineers work abroad immediately after graduating from university, the vast majority return to Sweden when it comes time to start a family.⁴⁷

Finally, it is becoming increasingly clear to many in both the private and public sectors in Sweden that the difference between Sweden's public sector and that of many other countries is not as clear as one might conclude by simply looking at the OECD figures. Health care spending is but one (albeit obvious) case in point. Clearly, health care and health care insurance are not matters of choice for most middle and higher income earners - everyone must have this insurance, whether it is paid for in pre-tax or after tax dollars.⁴⁸ Thus, whether doctors, nurses and hospitals are paid for via private insurance or public compulsory insurance will not necessarily affect individual or business location decisions. The quality of that care is substantially more important issue.⁴⁹ As one high level and widely respected Social Democratic official told me, There will be increased competition between countries due to internationalization, he argued. But it won't be the country with the lowest tax rates that wins. It will be the countries which have the most efficient use of resources that win.⁵⁰

Rethinking the New Political Economy

In the crisis period of the 1930's and 1940's it was quite common to hear both pundits and

scholars argue that capitalism had come to a crossroads: Either economic change or political demands (or both) had brought about a transformation of capitalism as it had been known. Looking back, however, one could instead argue that it was the very policies developed in these decades that effectively saved capitalism.⁵¹ Instead of killing the market, the regulatory and welfare state programs that so many feared, had the opposite effects: By redistributing wealth and dampening the swings of the free market, state policy effectively increased aggregate demand and reduced uncertainty. The results were - contra the chicken little hysterisists - a virtuous cycle of growth, productivity, and increasing prosperity.

At the beginning of the new century, modern capitalism is undergoing a transformation perhaps as dramatic as those witnessed earlier in the last century. Not only is capital and labor more internationally mobile than it has been in any time since the end of WWI, but new technologies of production also increasingly pressure capitalists and policy makers alike towards more flexible regimes.⁵² These changes, however, do not spell the end of the welfare state any more than changes earlier in the century spelled the end of capitalism. Instead, we are witnessing another Great Transformation. One in which the specific relationship between public and private power is once again a subject of contestation.

Clearly, the multiple equilibria observed of the later part of the 20th century have been upset. This does not suggest, however, that a new *single* equilibrium is imminent. Quite the contrary, institutional variation will once again structure how different nations respond to economic change and as a result, multiple equilibria are certain to continue. In this sense, our analysis confirms a recent analysis suggested by Fritz Scharpf, There is, in other words, no one best way through which advanced welfare states could maintain their economic viability in an

environment of international capitalism without abandoning their employment, social security and egalitarian aspirations.... [and] there is no reason to think that economic viability should be incompatible with the successful pursuit of these aspirations.⁵³

Sweden has achieved remarkable economic success *and* egalitarian outcomes in recent years. It is clear to virtually all analysts that the key to these redistributive outcomes has been the universalistic social programs which provide benefits to all citizens regardless of wealth and income.⁵⁴ Because they are universalistic, however, they are very expensive. At the same time, because they are universalistic they generate enormous popular support. Thus - even in the event of slow economic growth - recent history demonstrates that it is exceptionally difficult to cut these programs. In the case of economic expansion, like that witnessed more recently, there are few incentives to move in this direction.

Sweden clearly faces important and very difficult political and economic challenges ahead. As in all advanced democracies, the aging of the population will mean an increasing share of its workers will be recipients of social benefits instead of contributors.⁵⁵ Potentially more troubling is the possibility that the growing ethnic heterogeneity of this nation will one day undermine the traditional nordic Swede s willingness to pay taxes for social programs that may increasingly go to racial and ethnic minorities. At this point, however, we see little direct evidence of this problem erupting in Sweden in any extent like that seen in several other European countries. What we can say here, is that the sky is not falling, at least not yet.

Endnotes:

1. There have been a large number of political scientists, economists and fiscal policy experts who have made various versions of these arguments. For some of the most blunt arguments made in this direction see: Bishop, M. (2000). "The Mystery of the Vanishing Taxpayer". *The Economist*. January 29 - February 4, 2000. Buerkle, T. (1999). "Sweden pays the price of high taxes". *International Herald Tribune*. Paris: 1. Kapstein, E. (2000). "Winners and Losers in the Global Economy." *International Organization* 54(2): 359-384. Lee, D. R. and R. B. McKenzie (1989). "The international political economy of declining tax rates." *National Tax Journal* 42(1): 79-83. McKenzie, R. B. (1989). "Capital flight: the hidden power of technology to shrink big government." *Reason* 20(10): 22-26. Rodrik, D. (1997). *Has globalization gone to far?* Washington DC, Institute for International Economics. Schjelderup, G. (1993). "Optimal taxation, capital mobility and tax evasion." *Scandinavian Journal of Economics* 95(3): 377-86. Steinmo, S. (1994). "An end to redistribution? tax reform and the globalization of the world economy." *Challenge* Nov/Dec.: 1-9. Tanzi, V. (2000). "Globalization and the Future of Social Protection". New York, International Monetary Fund: 1-22. Tanzi, V. (1995). "Taxation in an integrating world". Washington, D.C., The Brookings Institution. Wriston, W. (1992). *The twilight of sovereignty*. New York, Charles Scribner and Sons.
2. Kitchelt, H., P. Lange, et al. (1999). *Continuity and Change in Contemporary Capitalism*.

Cambridge, Cambridge University Press. Scharpf, F. (2000). The viability of advanced welfare states in the international economy: vulnerabilities and options." *Journal of European Public Policy* 7(2): 190-228. Swank, D. (in press). *Diminished democracy: globalization, political institutions, and policy change in developed welfare states*. New York, Cambridge University Press.

3. There are a number of good studies showing how this model of social corporatism worked in practice. For a general overview see: Hancock, D. (1972). *Sweden: the politics of post-industrial change*. Hinsdale, Illinois, The Dryden Press. Lewin, L. (1970).

Planhushallingsdebatten (The debate on planning). Stockholm, Almqvist and Wicksell. For some more recent work analyzing this system and its political/economic consequences see: Katzenstein, P. (1984). *Small states in world markets: industrial policy in Europe*. Ithaca, Cornell University Press.. Rothstein, B. (1986). *Den social-demokratiska staten (The social democratic state)*. Lund, Sweden, Arkiv Avhandlingsserie..

4. This was called the Solidaristic Wage Policy in which LO unions would hold down wages in the most productive/profitable sectors (large firms, manufacturing, mining etc.) and push up relative wages in the less productive/profitable sectors (textiles, farming, small firms). The idea was to encourage structural modernization and change in the economy by literally increasing profits in some sectors while driving other companies and sectors out of business. Swenson, P. (1989). *Fair shares: Unions, pay, and politics in Sweden and West Germany*. Ithaca, New York, Cornell University Press..

5. Most importantly, the Ghent unemployment insurance was established which effectively gave the unions control over unemployment insurance Rothstein, B. (1992). "Labor market institutions

and working class strength". *Structuring Politics: Historical institutionalism in comparative politics*. S. Steinmo, K. Thelen and F. Longstreth. New York, Cambridge University Press: 33-

56.. But other pro-union public policies were also set up and certainly the anti-union incentives common throughout the capitalist world were eliminated.

6. Pontusson, J. (2000). "Labor market institutions and wage distribution". *Unions, Employers and Central Banks: Macro-Economic Coordination and Institutional Change in Social Market Economies*. T. Iversen, J. Pontusson and D. Soskice. New York, Cambridge University Press: 292-330.

7. Sweden was widely known around the world for possessing an arsenal of revenue devices. Norr, M., F. Duffy, et al. (1959). *Taxation in Sweden*, Little Brown. designed to lower the costs of capital, concentrate resources, encourage domestic investment in plants and machinery and thus keep Swedish economy competitive and dynamic. In fact, tax write-offs available to companies and capital were so generous that the Swedish tax authorities almost never bothered to audit large companies knowing that these companies had easy access to more write-offs than they generally took advantage of.

8. See Steinmo, S. (1993). *Taxation and democracy: Swedish, British and American approaches to financing the modern state*. New Haven, Yale University Press.

9. Several changes were introduced in the new Constitution. The most significant, however, was the elimination of the upper house of the Riksdag. Sydow, B. v. (1989). *Vagen till enkammar riksdagen: Demokratisk forfattningsspolitik i Sverige 1944-1968*. Stockholm, Tidens forlag.. This reform transformed Swedish governance in that now a relatively small change in election outcomes could actually change who held the reigns of government. The Social Democrats, in

fact, lost power in 1976.

10. A series of policies were demanded and implemented (such as health and safety policies) but the most significant specific reform was the demand for worker co-determination policies designed to include unions in corporate decision making.

11. Wage Earner Funds were to be created though both increased profits taxes and increases in wage taxes. Though never fully implemented, the idea behind this policy was to create a huge public funds which would essentially buy out Swedish capital and thereby realize the socialist ideal of workers owning the means of production. See: Åsard, E. (1984). *Industrial and economic democracy in Sweden: From consensus to confrontation*. ECPR, 12th Joint Session, Salzburg, Austria..

12. Ruin, O. (1981). "Sweden in the 1970's: police-making (sic) becomes more difficult". *Policy styles in western europe*. J. Richardson. London, George Allen and Unwin: 141-167..

13. Rothstein, B. (2000). "Trust, Social Dilemmas, and Collective Memories". Gothenburg, Sweden, Department of Political Science..

14. The extent of the Swedish Social Welfare system s generosity became legend. See SOU (2000). *Välfärd vid Vägskäl [Welfare at the crossroads]*. Stockholm, SOU. for a more complete analysis of the Swedish welfare system and its benefits.

15. Agell, J. (1986). "The effects of capital taxation : an equilibrium asset market approach". *Studia economica Upsaliensia 9*. Uppsala, University of Uppsala: 123. Agell, J. and P. -A. Edin (1989). "Tax reform and individual investor response : evidence from Swedish tax return data". *Working paper - Fackföreningsrörelsens institut för ekonomisk forskning 68*. Stockholm, Fief: 18, 8 s.

16. The TCO and SACO-SR represented just 18.2% of unionized workforce in 1950. See Jonung (1999) for a detailed analysis of the politics of inflation/evaluation during the 1970s and 1980s. Jonung, L. (1999). *Med backspegeln som kompass : om stabiliseringspolitiken som läroprocess: rapport till ESO - Expertgruppen för studier i offentlig ekonomi. [With the rearview mirror as a compass: on stabilization policy as a learning process: report to the ESO expert group for the study of the official economy]*. Stockholm, Fakta info direkt. See also, Moses, J. (2000). "Floating fortunes: Scandinavian full employment in the tumultuous 1970s-1980s". *Globalization, europeanization and the end of Scandinavian social democracy?* R. Geyer, C. Ingebritsen and J. Moses. London, Macmillan: 62-84.
17. Notermans, T. (2000). "Europeanization and the crisis of Scandinavian social democracy". *Globalization, Europeanization and the end of Scandinavian social democracy?* R. Geyer, C. Ingebritsen and J. Moses. London, Macmillan: 23-44. page, 24.
18. Interview with author, April 2000.
19. For Feldt's version of these events see, Feldt, K.-O. (1991). *Alla Dessa Dagar (All Those Days)*. Stockholm, Norstedts..
20. See for example: Hadenius, A. (1986). *A crisis of the welfare state? Opinions about taxes and public expenditure in Sweden*. Stockholm, MiniMedia AB. Edlund, J. (1999). *Citizens and taxation : Sweden in comparative perspective*. Umeå, Umeå University Press.. Svallfors, S. (1989). *Vem älskar välfärdsstaten? : attityder, organiserade intressen och svensk välfärdspolitik [Who loves the welfare state? attitudes, organized interests and Swedish welfare policy]*. Lund, Arkiv..
21. The recent literature on ideas in politics is growing enormously Berman, S. (2001). Ideas,

Norms and Culture in Political Analysis." *Comparative Politics*. Blyth, M. (1997). Any More Bright Ideas? The Ideal Turn of Comparative Political Economy." *Comparative Politics* 29(2 (January)). Marcussen, M. (2000). *Ideas and Elites: The social construction of economic and monetary union*. Aalborg, Aalborg University Press.. Unfortunately, too often the concepts of ideas, values, beliefs and culture are conflated. For our purposes here, we mean ideas in the quite normal sense of the word... I, have an idea! Let s... In this sense, an idea is a problem solution. We may agree on the objective, goal etc., but have quite different ideas about how to get there. Our ideas are in fact probabilistic arguments about future outcomes.

Values, on the other hand, are better understood as fundamental preferences proscribing the appropriate structure of society. We may have different values, for example, if I prefer a more equalitarian society than you do.

22. Sjöberg, T. (1999). Intervjun: Kjell-Olof Feldt [Interview: Kjell-Olof Feldt]." *Playboy Skandinavia*(5): 37-44.

23. Sverenius, T. (1999). *Vad hände med Sveriges ekonomi efter 1970? (What happened with the Swedish economy after 1970?)*. Stockholm, SOU (Statens Offentliga Utredningar). See the following accounts for influential arguments presented in public debate that contributed to the change of views inside the government and out: Myrdal, G. (1982). "Dags för ett bättre skattesystem [Time for a better tax system]". *Skatter [Taxes]*. L. Jonung. Malmö, Liberforlag. Muten, L. (1988). "Tax reform - an international perspective". *Vårt Ekonomiska Läge [Our economic situation]*. Stockholm.

24. Some of the economic analyses included: Agell, (1986) op. cit.. Bertmar, L. (1983).

"Företagsbeskattning - behövs den? [Capital taxation: do we need it?]" *Hur Klarar Vi 1990?*

[How do we make it in 1990?]. A. Lindquist and S. Stigmark. Stockholm, Riksbankens Jubileumsfond. Eklund, K. (1984). Vad göra med skatterna? [What should we do with taxes?]." *Affärsvarlden* 29(2): 7-17. Lodin, S.-O., G. Lindencrona, et al. (1978). *Beskattning av inkomst och förmögenhet, del 1 och del 2 [The taxation of income and wealth, parts 1 and 2]*. Lund, Studentlitteratur. Muten, L. (1988). "Tax reform - an international perspective". *Vårt Ekonomiska Läge [Our economic situation]*. Stockholm. Södersten, J. (1983). *Skatt på Bolagskapital (The taxation of corporate capital)*. Stockholm, Thomas Lindberg.. Official government research reports included: SOU (1983). *Skall Moms Slopas? [Should VAT be graduated?]*. Stockholm, SOU. SOU (1984). *Förenklad själv deklARATION [Simplified Self Declaration]*. Stockholm, SOU. SOU, 1989 #846] SOU (1989). *Reformerad företagsbeskattning [reformed corporate taxation]*. Stockholm, SOU. SOU (1989). *Reformerad Inkomstbeskattning [Reformed income taxation]*. Stockholm, SOU.

25. (Anonymous) interview with author, June, 2000.

26. See Steinmo, (1993) op. cit. pp. 182-187, for a list of some of the reforms introduced in the 1980s. Overall the tax system witnessed several hundred specific changes in this period.

27. Sweden was in the midst of the most serious recession in post-war history at the time. Thus it is difficult to specifically evaluate the exact costs of the tax reform. Subsequent analyses, however, suggest that the reform cost the Treasury approximately 3% of GDP (Agell, et. al. 1998).

28. Essentially, a two rate personal income tax system was created. All taxpayers paid flat rate local income tax rate (30% in most districts). Income over 74,824 Krona (approx. \$9,500) per year were also subject to the flat rate national income tax of 20%.

29. Indeed, after this reform, the tax code possessed so few tax write-offs that the government would simply send a letter to the taxpayer showing the amount of income they had earned in the year and asked the taxpayer to confirm that they had no extra (not already taxed) income. Since there were so few tax exemptions left in the system, the taxpayer could simply sign the slip and send it back to the authorities... no further taxes would be due, and no tax refund would usually be issued.

30. This 50% figure is drawn from adding the local and national income tax rates together. Before the reform, this write-off was so tax favorable that a large number of Swedes borrowed money for investment (particularly in real estate) and then deducted the interest. Given that almost all Swedes at that time had marginal income tax rates between 50 and 80 percent, this meant that the government effectively paid at least half of the cost of the investment. This cash machine resulted in a *net loss* in capital income tax revenue to the government Agell, J., L. Berg, et al. (1995). "Tax reform, consumption and asset structure". *Tax reform evaluation report 16*. Stockholm, National Institute of Economic Research: 48. .

31. Now the income tax was essentially a flat rate income tax for most income earners, (avg. 30% depending on the commune) with a second rate of 20% affecting only higher income earners.

32. For a balanced analysis of this tax reform and its fiscal effects see: Agell, J., P. Englund, et al. (1996). "Tax reform of the century -- the swedish experiment." *National Tax Journal* 49(4): 643-664..

33. By substantially eliminating the deductibility of interest even on owner occupied homes, those who had borrowed to finance purchases now found they could not afford their loans. Given that this occurred inside a general recession, the result was a collapse of the market.

34. Former Communist Party.
35. Thus, for example, employees were no longer eligible for full pay for up to seven days sick leave even when they had no slip from a doctor. A number of similar reforms were reduced as well. Some, of course, cause considerable financial hardship in specific public bureaucracies. The health care sector appears to have been particularly hard hit. For an overview of the social security in Sweden after the changes in the 1990s see: SOU (2000). *Välfärd vid Vägskäl [Welfare at the crossroads]*. Stockholm, SOU..
36. See also, Finance, M. o. (1995). "The Medium Term Survey of the Swedish Economy". Stockholm, Ministry of Finance. page 402.
37. OECD (1999). *Sweden - Economic Survey 1999*. Paris, OECD.
38. Ministry of Finance, (2000), *National Report on Economic Reform: Product and Capital Markets*, Ministry of Finance, Stockholm. Page 2.
39. *Gothenburg Post*, 4-14-2000, p.1
40. (Anonymous) interview with author, June 2000.
41. Lindbeck, A. (1997). *The Swedish experiment*. Stockholm, Studieförbundet Näringsliv och samhälle.
42. See, Hadenius, A. (1986). *A crisis of the welfare state? Opinions about taxes and public expenditure in Sweden*. Stockholm, MiniMedia AB. Edlund, J. (1999). *Citizens and taxation : Sweden in comparative perspective*. Umeå, Umea University Press. Svallfors, S. (1989). *Vem älskar välfärdsstaten? : attityder, organiserade intressen och svensk välfärdspolitik [Who loves the welfare state? attitudes, organized interests and Swedish welfare policy]*. Lund, Arkiv. Svallfors, S. (1997). *The Middle Class and Welfare State Retrenchment: Attitudes Toward Swedish Welfare Policies*. Third Conference of the European Sociological Association, University

of Essex, August 27-30, 1997.

43. In Sweden a political party must reach 4% of the total vote to get representation in the Riksdag (parliament).

44. For historical elaborations of this argument see Steinmo, S. (1988). Social democracy vs. socialism: goal adaptation in social democratic Sweden." *Politics and Society* 16(4): 403-446..

See also Pontusson, J. (1987). Radicalization and retreat in Swedish social democracy." *New Left Review*(165): 5-33..

45. See for example Economist (2001). "Is government disappearing?". *Economist*.

www.economist.com 11/19/2001..

46. (Anonymous) interview with author, May 2000.

47. Interview with Knut Rexed StatseSecretar, June 2000.

48. Indeed, in some countries, like Switzerland, it is mandated by the government, but is called private insurance and thus does not appear as a public expense.

49. For an excellent analysis of this dynamic in Sweden see Kumlin, S. (2002 (forthcoming)).

"Institutions - Experience - Preferences: Welfare state design affects political trust and ideology".

Structuring the Welfare State: Institutional Legacies and Policy Change. B. Rothstein and S.

Steinmo. New York, Palgrave..

50. Knut Rexed StatsSecretar, June 2000.

51. Lindblom, C. (1973). *Politics and markets*. New York, Basic Books. Schumpeter, J. A.

(1947). *Capitalism, socialism, and democracy*. New York London, Harper & brothers.

52. Economist (2000). "Have factory will travel". *Economist*. 354: 65-66. Brooks, S. (2000).

"Understanding the Recent Change in the Structure of Global Production (Chapter 4)". *Political*

Science. Princeton, Yale University. Drucker, P. F. (1986). *The Changed World Economy*."

Foreign Affairs 64(4): 768-791.

53. Scharpf (2000), op. cit. p. 224. See also Soskice, D. (1999). "Divergent Production Regimes:

Coordinated and Uncoordinated Market Economies in the 1980's and 1990s". *Continuity and*

Change in Contemporary Capitalism. Cambridge, Cambridge University Press: 101-134.

54. Rothstein, B. (1998). *Just Institutions Matter: The Moral and Political Logic of the*

Universal Welfare State. New York, Cambridge University Press..

55. Sweden is actually in a far better position than many of its contemporary welfare states with

respect to this issue. The success of the Tax Reform of the Century led the government to go

on to introduce a major overhaul of the Social Security system. Sweden's moderately open

immigration policy (when compared to most other EU nations at least) and her remarkable (tax

financed) social support of young families encouraging them to have more children also place this

country in a better demographic position than most other European states.