

Estoril 2011-06-28 The New Swedish Model

Thank you very much for inviting me to these very interesting days in lovely Estoril. My topic for today is "*The New Swedish Welfare State*" and, of course, you ask yourself "*what happened to the old Swedish model?*"

And perhaps there is no entirely new model. But maybe there was a kind of parenthesis, a kind of experimental episode, when the Swedish model were tested and sometimes stressed to its limits.

Since I have rather short time I will skip the history part and start in the middle 80:s, a time when socialist experimentation was beginning to exert it's toll and the negative effects of high marginal taxes and regulations were beginning to show in Sweden.

The 80's, as in many other parts of the world, were the turning of the tide. It was the era of Ronald Reagan and Maggie Thatcher. And although Sweden was rather leftish, politically, it was the start of political and economic reforms even there.

It started with the deregulation of credit and foreign exchange markets. The regulations were not politically motivated, but rather deemed "*necessary*" to create a well functioning economy.

In the beginning of the 1990:s selected markets were deregulated, like taxi, telephone, energy, postal and airline markets. Then came a large tax reform. Not ideologically motivated, but rather deemed necessary because of the perverse effects of high marginal taxes and highly tax-subsidised borrowing.

The tax reform was initiated and muddled through politically by the Social Democrats and the center-right party Folkpartiet. The tax reform reduced the top marginal tax rate - from 73 to 51 per cent.

Unfortunately, reduced inflation, lower marginal tax rates, a fixed exchange rate and a deregulated capital market combined to create a huge economic crisis in Sweden.

However, this economic setback did not stop the reform-process. After 1992, and perhaps as a response to the crisis, the central bank became independent, while the budgetary process was reformed to produce greater stability. A goal of a one per cent budgetary surplus across the business cycle was instituted.

There were also a large number of reforms of the public sector, mainly inspired by the ideas labelled as "*New Public Management*". There were reforms in the health care sector, starting in the Stockholm county council. The school system was transformed into a voucher system, where private schools could compete on equal terms with public schools.

The ban on private job placement services were abolished, and many local communities were introducing competition within welfare services, such as elderly care, childcare, et cetera.

Because of the economic crisis, the welfare system had to become less generous. The benefit levels (still rather high) were reduced in order to save money. Of course, these measures also had the side effect of making it more advantageous to work more.

In 1995 Sweden joined the EU. This put further restrictions on anticompetitive behaviour by the state and local government.

And in 1997 a new pension system was introduced, the first “*notional contribution system*” (NCS) in the world, a pension system that works as is it was fully funded, without the capital requirements needed in a fully funded system. If the expected contributions to the system over time are lower than the expenditures, the pensions for existing and future pensioners are automatically adjusted. This happened for the first time in 2009, due to the financial crisis. Over time, however, the pension levels will be restored and are expected to assume its normal path of growth in 2016.

The inheritance and gift taxes were abolished in 2004. The arguments were mainly of an economic nature. The tax receipts were rather low and the distortionary effects were quite high.

The conservative government elected in 2006 has continued the reform process. In 2006 the wealth tax was abolished, but the major tax change by the new government was a new earned income tax credit. The reform has significantly reduced taxes for people in all income levels and raised the economic returns from working and working more hours. The taxes today are at least 180 euros lower on a monthly basis for an average worker in Sweden, compared to before 2006.

Tax deduction for household services was introduced in 2007 and there have been major new reforms of the social benefit systems. The changes have not focused mainly on the benefit levels, but rather on increased conditionality.

The voucher system for lower education has been kept intact and in 2010 a similar reform were introduced within the health care system (primary care). In essence the reform entails three important mechanisms; the patients may freely choose their primary care provider, the providers may establish new clinics and all providers (even public providers) must be treated equal by the county councils. However, all providers (private or public) must compete for existing patients.

The reform has generally increased the number of health care providers and put more focus on quality and accessibility. This has been popular with the general public, since the Achilles heel of the Swedish system has traditionally been accessibility.

Sweden used to have a retail trade monopoly for pharmaceuticals (both prescription drugs and OTC). Thus, the number of drugstores in Sweden has been fairly low by international standards. But in 2009 the retail monopoly was abolished, a reform which has increased the number of pharmacies in Sweden by some twenty per cent.

The tax- and welfare benefit reforms has had a quite spectacular effect on sickness absence during these years. The number of people on sickness benefit has decreased by 70 per cent during a seven-year period and the number of people on disability benefit is expected to decrease rapidly in the years to come.

Since this is Sweden we have absolute control over what everybody is doing in the country and as you can see the number of people who are depending on transfers from the government will decrease rapidly, unless something really nasty happens to the euro. Sweden is not a member of the euro, as you might know, but we are highly dependent on exports for our economic welfare.

Sweden is perhaps the fastest growing developed country right now. We can trace this economic success story back to a number of liberal reforms and a basically non-corrupt society, at least on the government level.

Individual responsibility and choice have been extended, while the role of politics has been reduced. Taxes and welfare benefits have been reduced, markets deregulated, business privatized and publicly financed welfare services produced by private actors.

We have also transformed the benefit system. Sweden might have the toughest eligibility standards for disability pension and in a few years we will most likely have fewer disability beneficiaries per capita than the United States.

All these reforms have been launched within the straitjacket of inflation- and budgetary targets. Sweden is one of the few countries that fulfill the Maastricht criteria and will in a few years have a quite negligible public debt (today 35 per cent, in ten years about 15 per cent).

Still, Sweden is definitely a welfare state with a quite extensive benefit system and mainly a public financing of education, health care and community services.

But, of course, there are still problems. We have problems of integrating people of foreign origin into the Swedish society. We have rather high youth unemployment. And we have difficulties of finding employment for people with disabilities.

These remaining problems are all connected to a lack of reforms in certain areas. We still have very high taxes, the labour market is too regulated (although not as regulated as in many other countries), and we still have too loose requirements for disability pension for the youngest (20-29 years).

The conclusions from Sweden, I believe, are that there is more to liberal reforms than the tax rate per se. Looking at Swedish statistics you notice the high tax rates, but tend to ignore everything that is difficult to measure in percentage levels. Digging deeper, we find some of the world's most radical voucher systems, a welfare system that really tests the eligibility of beneficiaries and a tax system that, given the high tax levels, is a fairly reasonable construct.

Although Sweden might be a star in its class, liberalising labour market regulations and further streamlining the tax-system to reduce distortionary effects could still improve performance. My conclusion is that welfare states indeed are sustainable, but that reforms are still needed. Sweden might be a model-country, but it is definitely a model that can be improved.

Thank you for your attention,