

Pär Nuder “Successful Social Democratic Financial and Economic Policy – the Swedish Experience”*

It is a great privilege to address you here at the Humboldt University. I'd like to thank the Stockholm office of the FES and the Institute for Northern Europe for making this possible.

As a Swede it is certainly a moment of trust to talk in the spirit of Dag Hammarskjöld. Even though he is mostly, and rightly, remembered for his strong leadership as Secretary General of the United Nations, it should today be mentioned that Hammarskjöld was an economist and served many years in the Ministry for Finance. He strived for a new world order, but also for modernizing Sweden.

Today I will try to share some experiences from Sweden during the years 1994-2006 when Social Democrats governed.

As you may know, in the late 19th century Sweden was one of Europe's poorest countries. In a rapid speed though, Sweden was transformed into a modern industrialized country.

A silent trilateral contract between the state, the business society and the trade unions made it possible to create *The Swedish Model*.

Capitalism *and* high taxes. Profitable industries *and* strong trade unions. Flourishing private sector *and* a high quality public sector.

Perhaps Sweden is a bit odd, also in our relation to Europe.

In 1994 a referendum took place. The outcome was narrow, but still clear: A majority wanted to join the European Union. Nine years later a new referendum decided – in a much clearer outcome – that Sweden should *not* join the European Monetary Union. For us on yes-side it wasn't possible to convince the Swedish electorate to join a club that had been worse off than Sweden.

Euro and non-Euro. That's only one example of the heterogeneousness within the European Union. Although we share certain common values, there are so many differences among national welfare state systems that the very notions of a *European Model* or *Social Europe* are, in my mind, rather dubious.

The Belgian economist André Sapir grouped the old EU – the EU 15 countries – into four different social policy models in order to examine their relative performance along a number of dimensions.

- The two *Anglo-Saxon* countries (Ireland and the United Kingdom) feature relatively large social assistance of the last resort. This model is characterised by a mixture of weak unions, comparatively high disparities in wages and a relatively high incidence of low pay.
- The *Continental* countries (Austria, Belgium, France, Germany and Luxembourg) rely extensively on

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insurance based benefits and old-age pensions. Although union membership is in decline, the unions remain strong.

- The *Mediterranean* countries (Greece, Italy, Portugal and Spain) concentrate their social spending on old-age pensions. The social welfare systems typically draw on employment protection and early retirement provisions, and in the formal sector, the wage structure is covered by collective bargaining and is highly compressed.
- And finally the *Nordic* EU countries (Finland, Sweden, Denmark plus the Netherlands) feature the highest levels of social protection expenditures and universal welfare provision. There is extensive fiscal intervention in labour markets, and strong labour unions ensure highly compressed wage structures.

When Sapir analyzed the four different groups he came to the following conclusion:

“The *Mediterranean model*, characterised by relatively low levels of employment and a high risk of poverty, provides neither equity nor efficiency. With the *Anglo-Saxon* and *Continental* models there appears to be a trade-off between equity and efficiency. Only the *Nordic* model, with high employment rates, and a low risk of poverty combines both equity and efficiency.”

In many peoples minds Sweden has been perceived as a model to follow – or to reject. But in 1994 Sweden and the model was undoubtedly in turmoil and therefore questioned as such.

In the early 1990s, Sweden experienced its deepest recession since the thirties. To cut a long story short, in three years public debt doubled, unemployment tripled and public deficit increased tenfold. In 1994, the general government budget deficit was the largest in the OECD area, 10 per cent of GDP.

The reason for this was a collapse in domestic demand due to a real interest rate shock. One

important factor was an increase in the household savings ratio by no less than 13 percentage points.

Some of the problems in the early 1990s were related to a Swedish habit in the 1980s: To devaluate the krona from time to time. Necessary structural changes were therefore not taken into action.

When the new Social Democratic Government took office in October 1994 the devaluation strategy had failed and we had to react, and act firmly. Only by substantially reducing the deficit, could Sweden achieve stability and sustainable growth.

We raised taxes and cut expenditures. We introduced a reinforce program of active measures of 7.5 per cent of GDP. After four hard years we managed to get public finances in surplus in 1998.

Parallel with the budget consolidation program, we introduced several structural reforms.

- We got access to the internal European market through joining the European Union.
- We reformed our pension system from an unsustainable pay-as-you-go system to a partially funded system with defined contributions with both private and public parts.
- We created a new budget process. We set up a system of nominal expenditure ceilings and a goal of public finances in surplus. Now we probably have one of the strictest budget processes in the world.
- We gave independence to our central bank and set up an inflation targeting regime.

What are then the results?

- *High growth*. Over the past decade we have had a higher average growth rate than both the EU average and the OECD average. Between 1995 and 2004 average GDP per capita growth

in Sweden was 2.6 per cent. In the US it was 2.2 per cent.

- *High employment.* Over the past twelve years we have had an employment increase of more than 400 000 people, or roughly 9 per cent of the labor force. The employment rate is the second highest in the European Union, approaching 80 per cent of the workforce. Unemployment has been falling and is around 4 per cent.
- *Low inflation.* Productivity growth in the private sector has gone from 2 per cent per year during the eighties to 3 per cent per year in the nineties. Disposable income has increased substantially. But the high productivity means that unit labor cost development has been flat between 2002 and 2006. Inflation is below 1.5 per cent.
- *Strong public finances.* Last year we had a surplus in public finances of about 3 per cent of GDP.

What are the explanations for this track record? Are there any competitive advantages that other countries could learn from? My personal answer is the following:

First: It has been a significant competitive advantage for Sweden to have strong public finances.

It is not only a question of reducing vulnerability for a small, open economy, it is also the basis for a well-functioning economy, with low inflation and high increases in real wages.

The day after I became Finance Minister I learnt that a long line with people demanding tax cuts was standing outside my office. On the third day I discovered a new line: People demanding higher expenditures. On the fourth day, to my consternation, I realized that same lobbyist frequently was standing in both lines at the same time: Car-owners demanding lower fuel-taxes *and* safer roads. Senior citizens dissatisfied with the pension demanding higher pension – *and* lower taxes.

You can imagine I soon realized my role in government.

For a Social Democrat - that wants a large public sector with generous social safety nets - strong public finances are a prerequisite for the political mission as such.

Strong public finances and sustainable surpluses are also a prerequisite for low inflation – a prerequisite for fair distribution. It was a Swedish blue-color-economist, Gösta Rehn that taught us, as he said, to *Hate Inflation*.

I am aware of the fact the some claim that inflation targeting can hinder expansion of domestic consumption. Let me therefore elaborate a bit on this point.

Sweden's monetary policy regime, and the functioning of the independent Riksbank, has recently been evaluated by two international well known economists, Professor Francesco Giavazzi and Professor Frederic Mishkin.

Their overall judgment is the following:

“...the Riksbank compares favorably with the best central banks in the world and that monetary performance has greatly improved from what occurred prior to the adoption of inflation targeting under an independent central bank. As a result not only the level and the volatility of inflation were significantly reduced, but the volatility of output has also diminished. This has been supported by a country that has good governance and government policies that have promoted fiscal responsibility, financial stability and growth in productivity.”

But, and this is an important “but”, they also note the following:

“However, in recent years the Riksbank has persistently undershot its inflation target; this has been associated with a loss in output and higher unemployment.”

Some years ago the Riksbank underestimated the productivity growth, and they have later admitted that their capacity to judge the real economy was too poor. But this doesn't lead either me or the professors to the conclusion that inflation targeting is wrong as such. But constantly you need to develop the tools for

setting the interest rate in line with the inflation target

A prerequisite for inflation targeting is a strong and general commitment to sound fiscal policy, and a strong commitment among the social partner on the labor market to have a wage formation in line with the inflation goal. And we do have that in Sweden. The trade unions support the monetary policy regime, and they ought to: The real incomes have increased every year the last decade.

So therefore, in my view, a real Social Democrat is someone who cares about strong public finances and low inflation protected by an independent central bank, by law forbidden to take any instructions from the Government.

The second competitive advantage is the fact that Sweden is an open economy.

As you may know, we have many international companies in Sweden, like ABB, Ericsson, Ikea, SAAB, Scania and Volvo. Our export as a share of GDP is 51 per cent, and our import as a share of GDP is 42.5 per cent. Germany is the largest trading partner and has recently outperformed the US. Overall 56 per cent of total Swedish exports go to the EU.

As a small and open country, Sweden has for long been a strong supporter of free trade. However, we must never take free trade for granted. Protectionism is growing. Many people fear higher international competition.

Protectionism is not the solution. On the contrary, free trade has been the driving force for the high growth in the world economy during the last two decades. Free trade is a necessary condition for high growth in the future. It is of great importance that we stand up for free trade.

But, it is not sufficient to be “free-traders”. We also need to be “fair-traders”. The enormous gaps between the rich and the poor in the world of today put pressure on us in the rich world.

Sweden is taking its part of the responsibility by having an official development assistance of 1 percent of gross national income. As a

small country, we are not part of G8. But we are proud of being member of G1.

As long as Europe hasn't opened up its markets, ODA-expansion is necessary. We need to share *both* our wealth *and* markets with others.

Having international competition is good, but you need to do your home work and open up your own domestic markets as well. The rich world spends about one billion US-dollars per day on agricultural subsidies alone, while the total spending on development aid is less than 300 million US-dollars per day.

Talking about markets, Former US Secretary of the Treasury, Larry Summers, once was asked what he thought was the main reason for United States outperforming Europe. And he was only allowed to give one reason. The answer he gave was not taxes, not the labor market, not the American universities - but their well functioning capital markets.

Inflows of global capital not only bring additional funds but also enrich economy and society through the transfer of new technology and management know-how. By ensuring efficient allocation of capital within the economy, well-functioning capital markets boost economic productivity and long-term growth.

Financial globalization has a definitive and obvious efficiency implication. Capital is attracted towards the opportunities of highest returns in the global economy.

Faced by the challenge of globalization, the countries that succeed are those that are open and flexible. Rapid technological changes and changes in international competition will inevitably require a constant flow of structural changes.

But what will happen with the woman or the man on the street in such an environment? They will fear change. They will fear globalization. They will fear China and India.

How to cope with fear for changes lead me to the third competitive advantage I think Sweden has had: Reliable *social bridges*.

There is no question that companies will close down and people will get unemployed as a result of international competition. The question is how the gains of globalization are distributed in the society.

Social bridges is a term used to describe measures aimed at reducing adjustment costs for employees when economic restructuring causes redundancies, and enabling them to seize new opportunities.

In Sweden, social bridges constitute a policy of protecting workers, not jobs. There are three main types of social bridges in the Swedish context.

First, there is *life-long learning*.

A good education increases people's opportunities of finding work in different companies in a range of industries. This places a major responsibility on regular education – from pre-school to university. They must have high quality and be available to everyone. But this is only part of the answer.

The other part is to have an educational system that give people several chances, several opportunities. If you never finished high school in your teens, you should be able to do it in your twenties, or in your thirties. And even later on. Economic opportunities for this must be provided.

Let me take an example.

During the economic crises in the 90's the Swedish government launched a program for unemployed without a degree from secondary school. 100 000 unemployed (in a 9 million country) were given the opportunity to finish their degree with a grant similar to their unemployment benefit.

Higher level education must also be inclusive rather than exclusive. Contrary to many other European countries everyone with a degree from secondary school can enter university. The choice you made when you were twelve years old will not exclude you from higher education. Or rather, the choice your mother and father made for you.

We have also expanded the number of universities and colleges across the country.

This has opened up higher education for new groups of students. Our goal is that 50 percent of each generation should start higher education.

My belief is that the future for Sweden is to continue to invest in education and research. Sweden has a well-educated population. We are spending a lot of money in all kinds of education – from childcare and primary schools, to higher education and research. The total investments in research and development in Sweden amount to almost 4 per cent of GDP.

The second kind of social bridge is *adjustment insurance*.

In the event of unemployment, illness and other forms of social exclusion people may need financial support. Unemployment insurance, sickness insurance and other benefits must be designed for people to find new jobs, while still providing security.

Almost all social benefits in Sweden are linked to your income. This means that if you are not working, or prove you are willing to work, you are out of the system. Thanks to our childcare system this policy is the same for single mothers. Or as some put it; we have a *workfare system rather than a welfare system*.

Or put it in yet another way, adjustment insurance should be a bridge to walk on. Not a platform to stand on. Constantly you therefore need to reform the insurance systems.

The third dimension of the social bridges concept is *re-introduction to working life*.

Many people who are inactive lose contact with working life and do not maintain the skills needed for working life. To make these people attractive on the regular labor market, it may be necessary to support their re-entry to the labor market by active labor market policies.

Unemployed should be given help to find a new job or given the possibility to retrain. We have a large number of programs ranging from on-the-job training to strict school education. An important aspect is to avoid that a culture of unemployment arises.

As I said: The idea is to protect people. Not jobs.

People need to feel that they, as individuals, are reasonably safe even if increased competition makes the company go bankrupt. By providing social bridges for people to move from old and no longer competitive jobs to new, more competitive ones we get, in return, a readiness for change and openness among the general public.

I would lie if I told you that this system means that Swedes loves change. They don't. But, they accept it.

Some years ago I visited a small town in mid-Sweden – a community totally depended on one industry: The steel-factory.

When I came there I met the local board of the steel workers union. They just had been informed that 100 men had to be fired, and now they prepared themselves for the negotiations with the management.

In Sweden we have a first-in-last-out principle. But with the exception that the unions and the management can jointly decide who will be excepted from this principle.

I asked the union representative, rather naive: How do you cope with this? I mean as human beings in a small town where everyone knows everyone?

What you have to do, are to pin-point those of your work-mates, your neighbors, your sons and daughters' best friends' fathers – and tell them that they have to quit. How do you manage that?

After a while they understood my question, and they answered:

“You see, the alternative is worse. Unless we don't do this necessary adjustment, the plant might not be competitive anymore. And if so, it may have to close down for good. And in that case our town will die.”

I went back to Stockholm, and asked myself: How come the steelworkers are so pro-change? They haven't studied macro economics at the famous Humboldt University – not even at the Stockholm School of Economics. The answer

is simple: By providing social bridges you create a flexible, dynamic society ready to adjust – even if it is painful.

This line of argument brings me to the fourth competitive advantage: Our culture of collaboration.

Some years ago one of our large firms, Electrolux, decided to close down a plant that made vacuum cleaners. The plant had about 400 workers and was located in a small city called Västervik with 22.000 inhabitants.

In France this would have created an outrage. The President of the Republic would have called for an all European globalization fund – and he got it... There would have been political strikes. The plant would have been under siege by militant unions.

I think you can recall what happened in your country when Electrolux closed down a plant in Bavaria.

In Sweden the blue collar trade union came out and said it had to accept the decision. Not with joy or satisfaction. But still – also this structural change was accepted.

When Segolénè Royal last year came to Sweden she asked me how come we have trade unions that are so prone to accept change.

There are two reasons for that.

I have already mentioned the social bridges – ensuring that people are not forced to sell their house because they get a fair unemployment benefit. They get training and education so that they become employable on a growing labor market.

The second reason why the trade unions are so progressive is the high union participation ratio – not at least due to the fact that the unemployment beneficiary system is linked to the membership in the trade union.

We have a union participation ratio of about 80 per cent among employed people. That creates strong unions that can bear a large responsibility. Or in other words, when they

try to maximize their member's utility they have to maximize the whole society's utility.

This creates a tradition of collaboration. We do have just as many different interests and opinions in Sweden as in any other society – but we realized early that Sweden is a bit too small for large conflicts.

Our fifth competitive advantage is the gender dimension's impact on the economy.

Many European countries face a huge demographic challenge. We know our population is ageing and that requires more people to work.

Sweden has a high employment rate compared to other European countries. I believe our high female participation ratio on the labor market plays an important role.

This is not something that just has happened. It is a result of policies designed to help both men and women to combine parenthood with working life.

The probably most important decision was made in the 70s when we started to build public childcare centers. Today these centers are open to all children whose parents are working.

They have high quality. They are open hours that make full-time work possible for both parents. The maximum fee is 200 dollars per month for fulltime childcare.

In many other countries either quality, cost or opening hours restrict the working possibilities for parents.

A second important reform has been our parental leave-system.

Parents have the right to stay home with their child for thirteen months – and receive 80 per cent of their monthly salary, up to a ceiling equal to 3.400 Euro, in benefit from the government during this time.

No parent can use more than 11 of these 13 months witch means that the father has to stay at home at least two months. Hopefully this will result in a more equal division of

responsibilities between the mother and the father as the child grows up.

Yes – the parental leave system is costly. Roughly around 1 per cent of GDP financed over the tax bill. But the system delivers: gender equality and therefore high employment ratio.

In my view, equality between women and men ought to be much more discussed in pure economic terms than only as a matter of justice between equal human beings. Here the economists have a mission.

The last competitive advantage I'd like to mention is the green dimension.

Sweden started early with policies aimed at switching to energy conserving and more environmentally friendly methods of production - and we are now seeing the results.

Despite high growth during the last decade, our emissions of greenhouse gases are actually lower today than in 1990.

We regard the green dimension as an important means to create a sustainable society, but we also regard it as a driving force for growth. The market for green products and green technology is a growing rapidly.

In order to support new technology we did not only support research in new technologies, we also gave generous tax reductions for cars using environmentally friendly fuels. Not only lower tax on the fuel, but also free parking in the inner city of Stockholm and no road-tolls.

Without particularly high costs for the government we can now see the number of bi-fuel cars exploding. Last year the numbers of "green cars" increased by 20 per cent.

So, to conclude: openness, education and research, strong public finances, high employment, gender equality, sustainable development, a tradition of collaboration on the labor market, and social bridges that make our society pro-change. There you find some

of the explanations why Sweden has outperformed average Europe the last decade.

Perhaps we are a bit a head of others, but the day you think your society is perfect; you shouldn't be in politics.

Even though unemployment is low by international standards, unemployment is too high by Swedish standards. Many Swedes are uncertain whether Sweden will be able to compete in the years to come.

Parents are asking themselves whether their kids will be worse off than themselves. People are worried that low-cost countries and their workers will take their jobs.

Sweden needs to stay competitive. There is no other way to succeed in the international economy. But what is the recipe for competitiveness? Some argue that lowering wage-costs, cutting taxes and reducing social security is the only way forward.

The new right-wing government has introduced a package of lower taxes and reduced unemployment benefits and made other cuts in the public insurance system. The overall aim is to put pressure on the lowest wages, and to cut the taxes to the average European level.

I think this policy mix is dangerous for Sweden's ability to compete in the future. The government's policy is not only unjust and creates new dividing lines between people, it creates uncertainty and insecurity.

Sweden has outperformed during the last decade despite – perhaps thanks to – a large welfare sector financed by high taxes. In my view the new government's policy will undermine the social bridges and therefore people's willingness to adjust in an uncertain, rapid age. One of our competitive advantages will be weakened.

My firm belief is that globalization makes the case for keeping the Swedish model even stronger. Globalization is not a race to the bottom. It is a race to the top.

We need to constantly develop the Swedish model, in order to stay competitive. But we

don't need to change model – as it is the model itself that is the base for our competitiveness.

The Swedish experience shows that those who claim that you cannot combine high growth with a fair distribution of income are wrong. On the contrary: our experiences show that it is possible to combine growth and social justice. Even in the era of globalization.

I don't think that everything we have done is duplicable everywhere. But some elements in our model are of universal character. Not at least to recognize the very idea of the model:

The more people dare to adjust, to move from no longer competitive jobs to new more competitive ones, the more competitive the country will be. Therefore are reliable social bridges a prerequisite for both social justice and economic success.

Finally:

After this Swedish flourish, I can imagine that some of you may consider a relevant question:

If everything is so competitive in Sweden – high growth, strong public finances, low inflation, and high employment – why on earth lost the incumbent Social Democrat government the general election eight month ago? Maybe the answer was given to me 14 years ago – without understanding it at that time.

In 1992 I visited Little Rock, the Clinton/Gore campaign headquarter, and the legendary war room. James Carville's famous writing was on the wall: *The economy, stupid.*

Today I know – the hard way – that the vice versa is also correct: *It's not only the economy, stupid.*