Twenty five years of Swedish reforms

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Summary

Sweden has implemented a series of market oriented economic reforms over two decades. This has been rewarded with a healthy recovery in economic performance compared to many European countries. Yet few articles in English describe these reforms, and especially the processes leading to their implementation. This paper tries to fill that gap with a straightforward account of the historical reform process, the reforms themselves, and a limited review of research findings evaluating their success. Those looking for a broader analysis of the political conditions conducive to reforms are referred to the newly published book ‘*Renaissance for Reforms*’ by Stefan Fölster and Nima Sanandaji (Timbro and Institute for Economic Affairs, 2014).

This paper will be updated at regular intervals adding reforms as implemented here in Sweden.

Introduction

Sweden was one of Europe's poorest countries during most of the 19th century. A wave of free trade reforms spurred economic growth remarkably, which was sustained the ensuing one hundred years. By 1970, Sweden had advanced to fourth place in terms of GDP per capita among OECD countries.

The seventies and eighties saw Sweden's tax burden rise from an average European level to the world's highest. The public sector expanded vastly. All facets of the welfare system were made more generous in international comparison. Meanwhile, labour market regulation increased and a system of collective employee investment funds (Wage-earner Investment Funds) was introduced, despite the risk this would transfer ownership in all listed companies to these union-controlled funds. Throughout these years, Swedes' individual after-tax real income stagnated, private sector job creation ceased, and public debt spiralled higher. This culminated in a severe economic crisis in the early 1990s. By then, Sweden had fallen to 14th place in the GDP per capita rankings of OECD countries.

By the late 1980s, many Swedes began to react to the country's lacklustre economic performance, lack of competition, and lack of choice in services, such as schools and healthcare provision. At first, a few public utilities and the financial markets were opened to competition, and an important tax reform was implemented. When the onset of the financial crisis coincided with election of a market-oriented centre-right government in 1991, the reform process began in earnest. Most emphasis at the time was placed on reforms that opened significant sectors in the economy to greater competition. Moreover, an important feature of these regulatory reforms was that the crisis spurred local authorities to implement less burdensome regulation. The financial sector was re-regulated from a more prudent perspective, and significant changes were introduced to the tax system, macroeconomic policy framework, and social insurance system. Sweden then joined the EU in 1995, precipitating additional competition laws and opening trade with the rest of Europe.

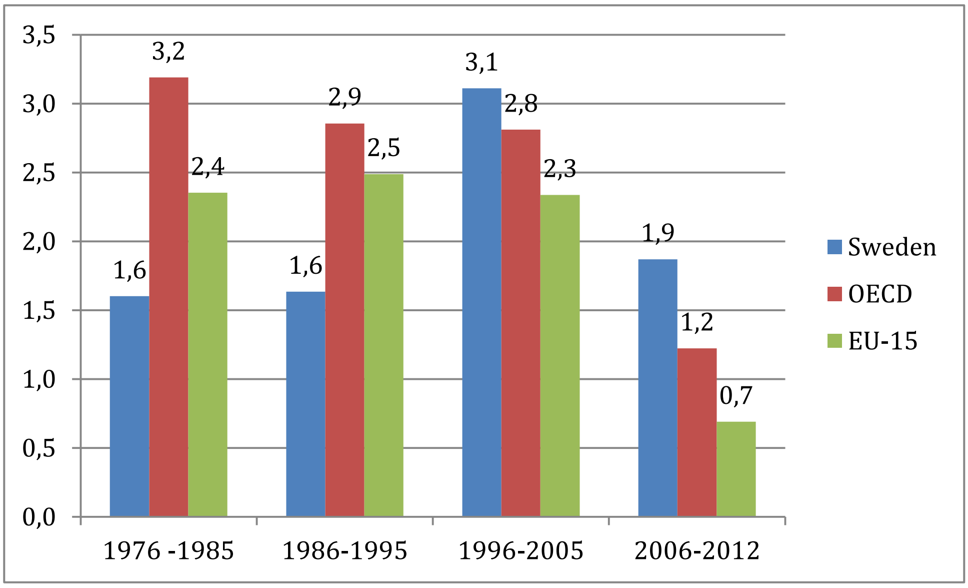
Reforming the Swedish economy in the nineties significantly impacted growth, private employment, and public finances. Yet taxes remained high, and the labour market remained unreformed (until a second wave of legislation from 2006 to 2010). We provide an overview of these periods of important reform below.[1]

[1] A good overview is also provided by Bergh (2011). In this paper we discuss many Swedish reforms in greater detail.

Swedish growth tracks reform trends

From 1976 to 1995, GDP growth in Sweden was about half the average of OECD countries and around one percentage point lower than the EU-15 countries. After 1996, growth in Sweden has exceeded both the OECD and EU-15 averages.

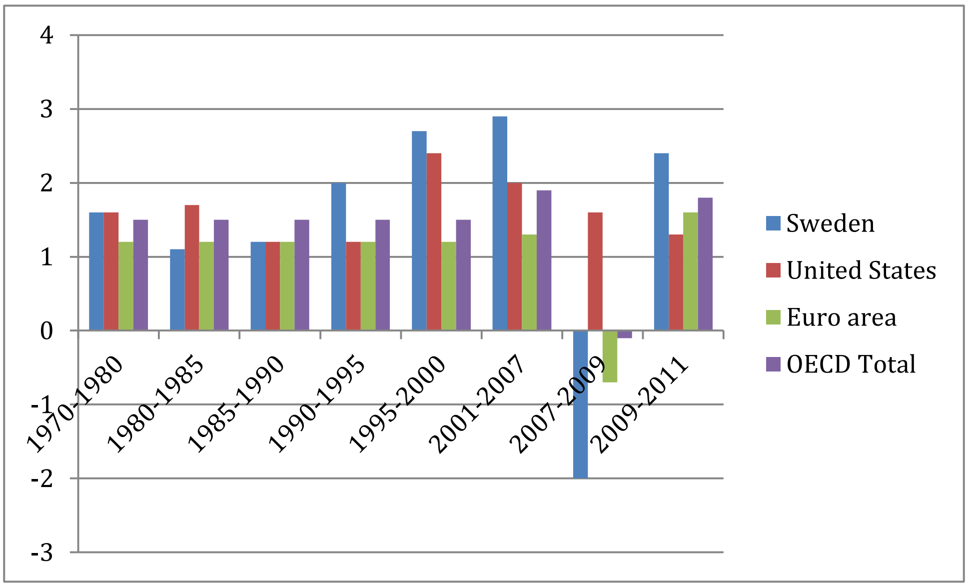
Figure 1. Yearly growth of GDP (fixed prices, fixed PPP) in specified time periods.



Source: OECD

This pattern of GDP growth occurred largely in the form of changes to productivity growth. During the eighties, productivity growth was low compared to other countries, but this picked up after the reform period in the 1990s (Fig.2).

Figure 2. Annual compounded growth rate of labour productivity

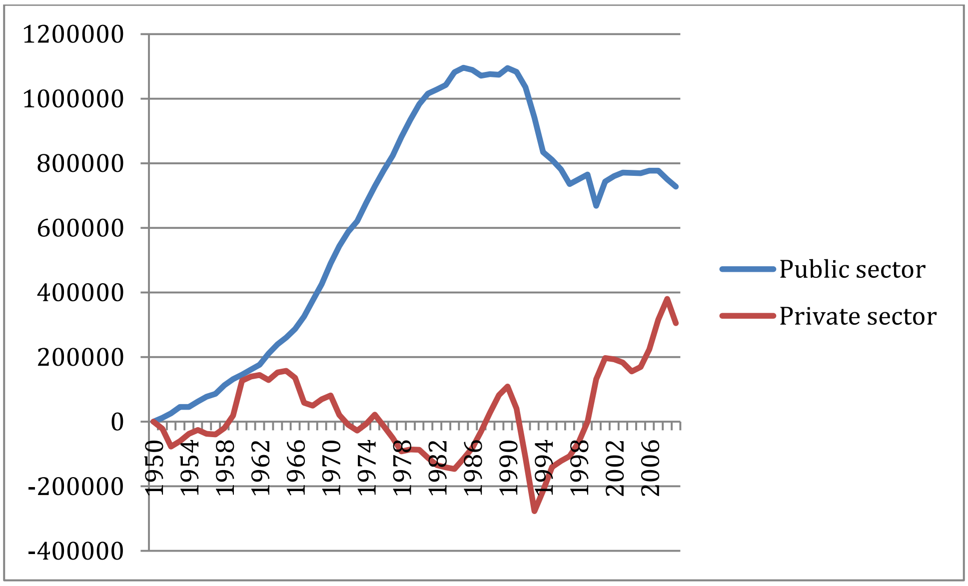


Source: OECD

Swedish productivity growth has remained higher than in other countries except during the financial crisis from 2008 and 2009, when the Swedish manufacturing sector experienced a sharp downturn. While productivity growth recovered after 2009, it remains below earlier trends.

The turnaround in productivity growth from the period of the seventies to the mid-nineties is also mirrored in employment patterns. Employment in the private sector shrank from the seventies into the nineties. Instead, the public sector expanded until the nineties economic crisis. Subsequently, private sector employment growth exceeded 1% annually, while public sector employment declined. This reversal is only partially explained by public services being opened to greater competition, or to public procurement tendering – where this service provision eventually ends up being supplied by the private sector.

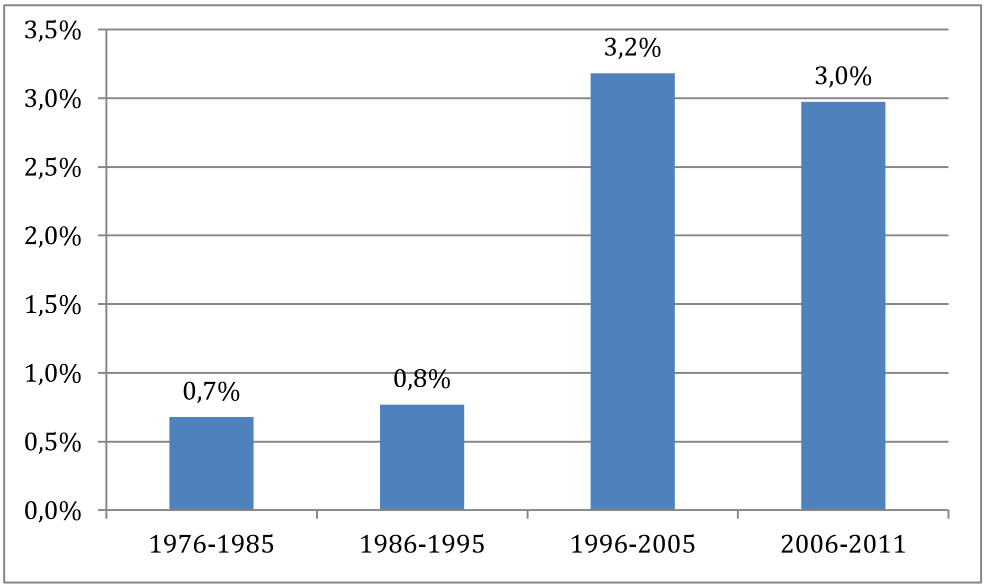
Figure 3. Cumulative change in employment in Sweden[2]



Source: Statistics Sweden

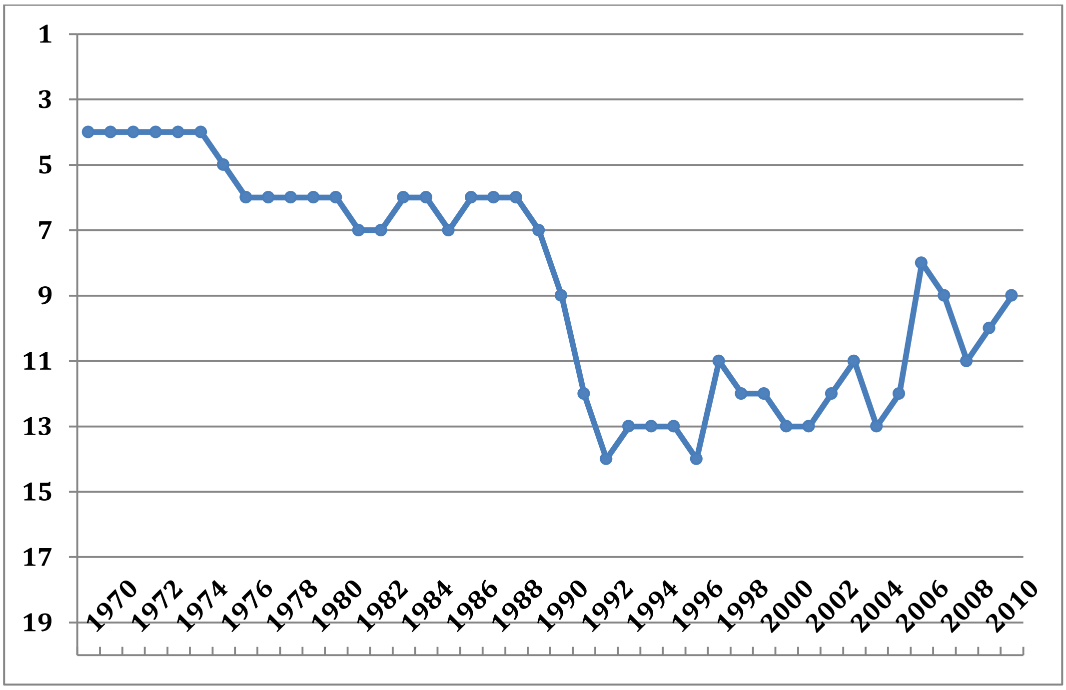
Swedish households gained tremendously from this turnaround. From 1976 to 1995 median disposable income of Swedish households grew 0.7% to 0.8% annually. This annual growth accelerated to around 3% after 1995. Disposable income thereby grew four times faster since then.

Figure 4. Annual growth of median disposable income in Sweden



Source: Statistics Sweden

Figure 5. Sweden's OECD ranking of countries for GDP per capita



Source: Ekonomifakta

In summary, every aspect of the Swedish economy has changed due to implementation of reforms. GDP and productivity growth are higher than in most comparable countries. Employment in the private sector has grown more than 1% per year, while public sector employment has declined. Public finances are now stronger than in most countries. And, as noted above, median disposable income in Swedish households grew 4 times faster after 1995 as compared to the previous twenty years.

This turnaround in the Swedish economy did not occur by accident. It was the result of many conscious steps taken by Swedish policy makers. Sweden implemented a considerable number of reforms before, during, and shortly after the 1990s crisis. We will examine many of these below.

The turnaround

At the onset of the economic crisis in the early nineties, Swedes were already increasingly demanding reform. Many specific reform proposals were vetted and packaged into reform agendas, as with the 'Lindbeck commission'.[3] One reason for these demands was poor economic performance over the

[3] Formally, the "Ekonomikommissionen" led by the economist Assar Lindbeck. For an English version see Lindbeck et al. (1993).

previous decades, which had been debated at length. Previous political responses to recessions in the seventies and early eighties were seen as failures. At that time, successive governments tried to save failing manufacturing giants with subsidies or nationalisation. All reviews of these rescue operations concluded they had been ineffectual. Therefore, political focus in the early nineties shifted to opening markets for competition instead of rescuing floundering businesses.

Further, national debt spiralled upward rapidly as the crisis of the early nineties deepened, which was correctly perceived to threaten the sustainability of Swedes' cherished welfare state. Paradoxically, weak public finances may have facilitated Sweden's reform process. With ballooning national debt, there was little room to stimulate the economy with expansive fiscal policies. Hence, the government was forced to concentrate on reforms that did not add more strain to public finances.

Steps towards greater competitiveness and growth were taken through reform of the tax system, financial markets, competition policy, and labour market. Meanwhile national and local regulators had to cut red tape. Competition was also enhanced by entry into the European Union. Previously sheltered companies and sectors were suddenly exposed to foreign competition. Another important change was the country's decision to abandon a fixed exchange rate and give the central bank a specific inflation target. In this light, we will analyse the major reforms in each of these areas that, together, changed the course of the Swedish economy.

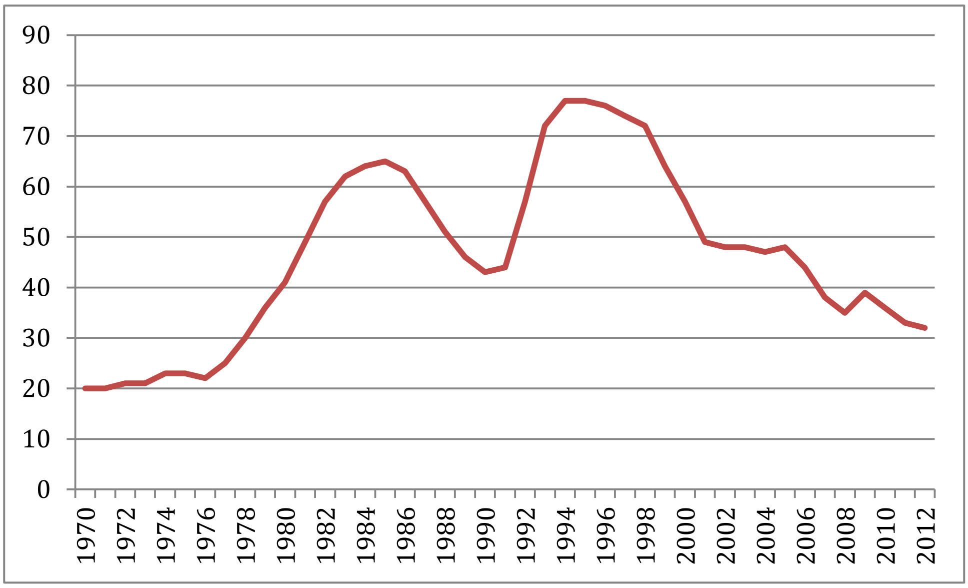
Public spending

By 1994, national debt totalled almost 80% of GDP, compared to nearly 30% in 2012. Naturally, high growth and low interest rates have helped reduce debt levels. But important reforms directly limiting public spending also made a decisive difference.

In 1997, a fiscal rule requiring a spending surplus was introduced. This introduced a target for government spending equal to 2% of GDP on average over the course of the business cycle. This fiscal surplus rule has since been lowered to 1% of GDP, and current discussions involve lowering it further to zero. To assist enforcing this fiscal rule, a public spending ceiling is set by parliament extending two to three years in advance. Additionally, internal budgeting procedures were revised requiring each ministry to finance every proposed expenditure increase with cuts from its own budget. In this way ministries are forced to prioritize much more than previously.[4]

A possibly more important change was introduced regarding the budgetary powers of minority governments. Such governments can now pass a budget bill in parliament even when they cannot win a majority in favour. If a majority of the opposition wants to fell such a budget it must gather a majority in favour of an alternative budget – which, in effect, would lead to a change in government.

Figure 6. Gross governmental debt as a percentage of GDP: Sweden

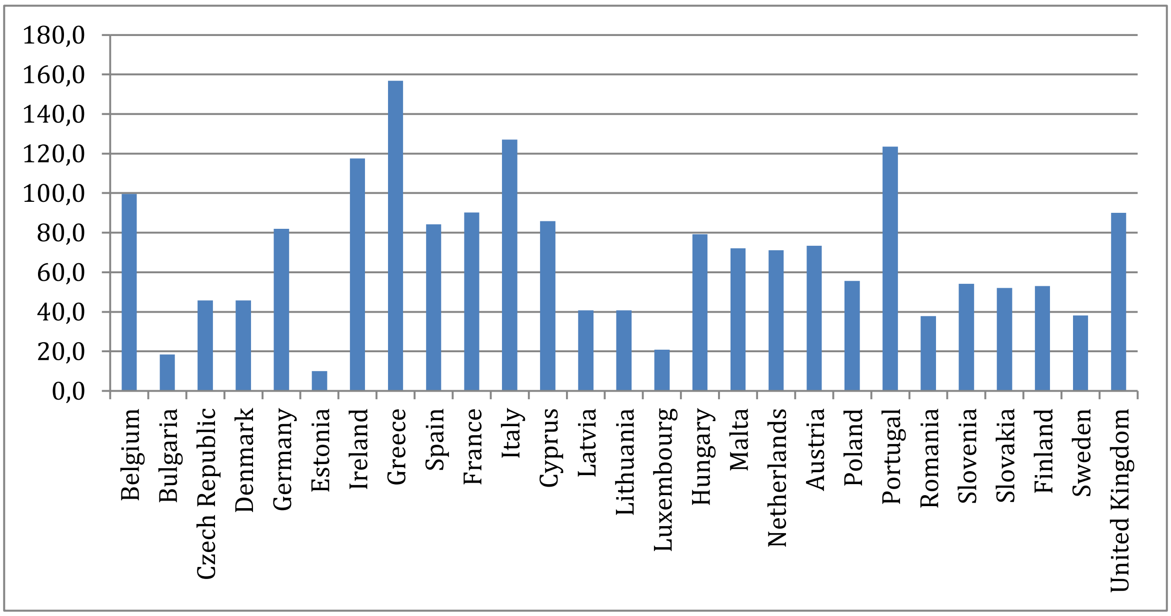


Source: Ekonomifakta

In international comparisons, Sweden's government debt is now low, a significant advantage in the current international economic downturn. Furthermore, the government owns considerable financial assets, so net financial wealth totals approximately 20% of GDP. Not surprisingly, Swedish interest rates have remained low during the financial crisis of 2008- 2010.

[4] For more information about the impact this balanced budget target and public spending ceiling, see Riksrevisionen RiR 2007:22.

Figure 7. European comparisons in government debt as a percentage of GDP, 2012[5]



Source: Eurostat

In addition, an early reform of the pension system contributed to the strength of Swedish public finances. After much discussion in the 1980s, the five major parties (Centre-right parties and the Social Democrats) came to an agreement that was implemented in several steps starting in the early 1990s. The previous pension system was mainly pay-as-you-go, with a pension based on individuals' 15 highest earning years over their career. The new system is still pay-as-you-go but simulates a funded pension in the sense that pensions are now based on the individual's total lifetime contributions. The funded portion of the system was converted from a state owned fund to individual accounts with limited freedom to choose how this is invested. During economic downturns, the new system also applies a 'brake' by reducing pensions until long-term expected revenue match expected pension outlays. This brake guarantees the long-term sustainability of the new pension system.

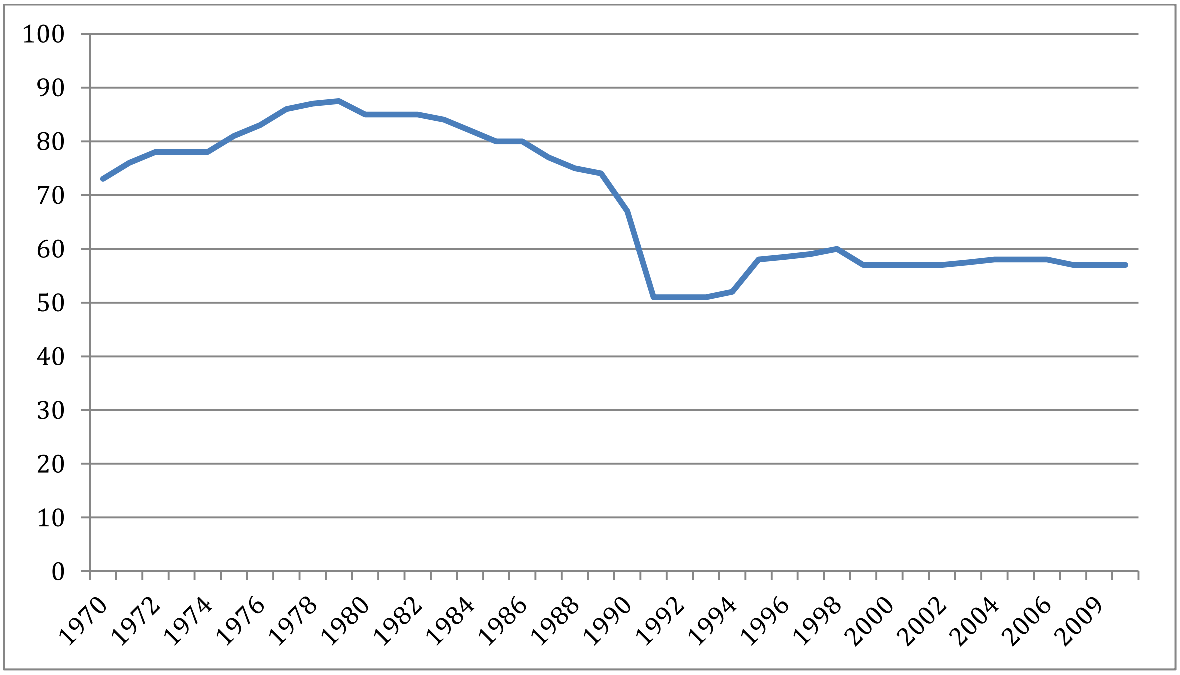
An equally important reform became known as the 'tax reform of the century', mainly implemented in 1991. Before, tax system created significant disincentives to work and invest. One reason for this was that individuals with similar incomes were taxed differently. For example, taxes on wages were much

[5] Eurostat defines government debt slightly different. Therefore, the level of Swedish government debt differs between figures 6 and 7. But still, the Swedish debt has fallen significantly and is now lower than most other countries.

higher than on benefits. Likewise, tax rates on capital income from interest on savings or dividends, for example, were significantly higher than on capital gains. As well, prior to this reform, VAT rates varied widely between many products and services.

The highest marginal tax rate in the old system was around 80%. The major tax reform in 1990-1991 had several aims. Income tax rates were reduced for everyone, with a target where 85% of all taxpayers would only be liable for local income tax, at rates near 30%. For incomes above a specified cut-off, individuals would pay 20% national income tax. This reform was fully financed by raising and equalizing VAT rates, abolishing various tax deductions, and raising capital income tax levels.[6] This achieved another aim in significantly reducing marginal tax rates without any reduction in total tax revenues.

Figure 8. Highest marginal income tax rate, 1970-2012, not including the marginal effects of employer's tax and VAT.



Source: Skattebetalarna och Ekonomifakta

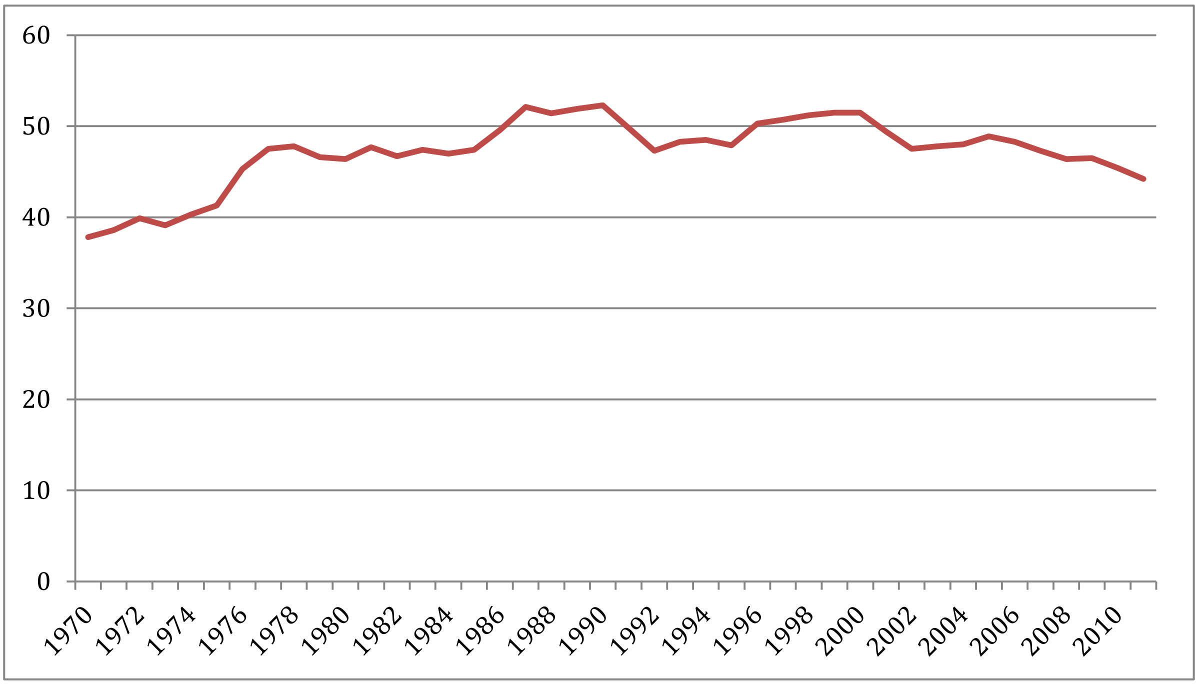
A similar reform of corporate income tax lowered rates from 50% to 30%, while abolishing many types of deductions. The reform was expected to be revenue neutral, but in fact revenue increased substantially after the rate cut.

6 Prop 1997/98 Appendix 6

Some other taxes on business were also cut. In the early phases of the 1990s economic crisis, political focus was on defending a fixed exchange rate. This led to temporary laws prohibiting price increases, and an internal devaluation. Then the Swedish krona was the allowed to float freely in 1992, but since government indebtedness had become so high, it was impossible to stimulate the economy on a large scale. But a few tax cuts were implemented, designed to bolster competitiveness, including lower energy taxes, payroll taxes, and capital gains tax. [7]

These tax cuts were financed by tax increases elsewhere and cuts in public expenditures. Transfers to municipalities were curtailed and savings were made in the social insurance system. These savings and tax revenues gradually led to lower interest rates on the public debt, further reducing public spending.

Figure 9. Total tax burden as a percentage of GDP



Source: Ekonomifakta

As can be seen in figure 9, total taxes declined in the nineties. In itself this may also have contributed somewhat to better economic performance.[8]

Nevertheless, reducing marginal tax rates was probably one of the more important reforms. It became more profitable to work, while borrowing became more costly. Still, other areas of the economy were subject to equally radical reforms.

[7] The Budget Bill 1991/92, 1992/93 and 1993/94.
[8] See e.g. Bergh and Henrekson (1993).

The labour market

Employment protection laws for permanent employees are stricter in Sweden than in most other countries.[9] For example, it is more difficult to dismiss individual workers for reasons other than redundancy than in many countries. In the early nineties a few steps were taken to liberalize employment protection laws. But, when the Social Democratic party returned to power in 1994, these reforms were rolled back. Overall, labour market legislation did not change much through the nineties. However, routines for wage negotiations were completely revamped between unions and employer organisations, tremendously impacting how the Swedish labour market functioned.

In the seventies and eighties nominal wage increases often amounted to 10% annually, a much higher rate than in most other countries. Problems were so severe that governments repeatedly took recourse to temporary legislation against strikes and price increases. Against this background, the Industrial Cooperation and Negotiation Agreement was launched in 1997. The major union and employer organizations agreed on new forms of annual collective wage bargaining. Under this regime, representatives meet continuously between bargaining periods. These organizations also nominate members to an economic council (IER), whose main objective is to analyse the economy, and provide a joint point of reference for wage negotiation. Further, unions and employers jointly appointed mediators who were given much more authority than before.[10]

Later, the national government's role in mediating labour conflicts was expanded with the creation of the National Mediation Office in 2001. The government now appoints mediators for disputes over pay and employment terms. In most situations now, unions and employers refer their disagreements to these mediators. But the National Mediation Office is entitled to force parties to mediation, though this rarely happens.

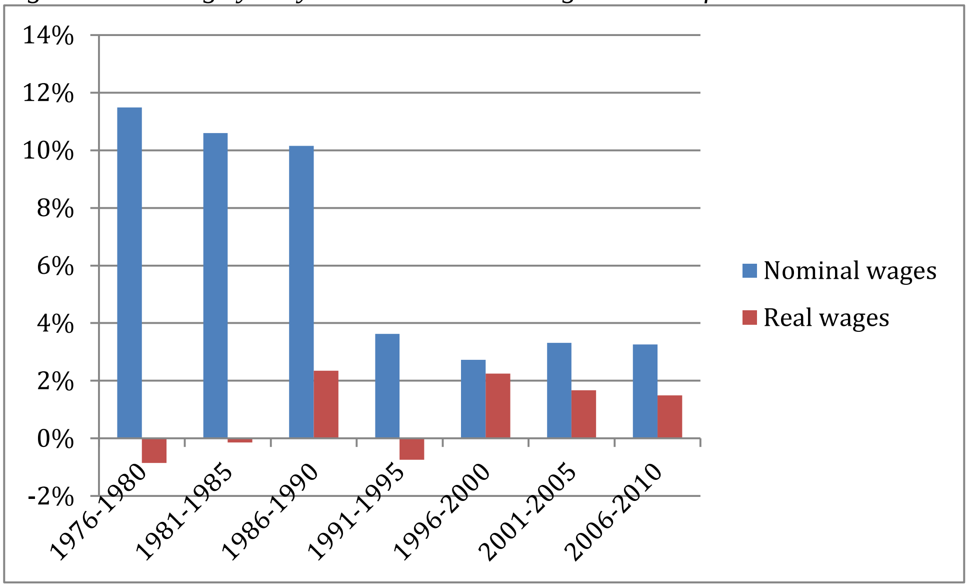
One important but increasingly controversial feature of the industrial cooperation and negotiation agreement is that wages for the manufacturing sector are negotiated first, and then that agreement serves as a benchmark for wages in other sectors. In fact, mediators are formally not permitted to propose agreements for wage levels exceeding this benchmark established in the industrial sector.

[9] See http://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm

[10] Elvander, Nils, Ekonomisk Debatt 2003, årgång 31, nr 1.

This new wage negotiation system has been quite successful. After a period of high nominal wage increases, but low or negative real wage growth, the past 15 years have seen low nominal increases that translate into higher real wage growth.

Figure 10. Average yearly nominal and real wage increase for blue-collar workers



Source: Fakta om löner och arbetstider (2012)

Reform of financial market regulation

In the midst of the early 90's financial crisis, the central bank (Riksbanken), succumbed to market pressure and abandoned its fixed exchange rate regime. The new objective for monetary policy became a 2% inflation target. This was added to the new Sveriges Riksbank Act, which also gave the bank greater political independence.

Adjusting to EU norms also shaped regulatory reform in financial markets. In line with Swedish political habit, a normal course of action after previous crises would have been to launch a committee of enquiry with official investigation into how to change regulation of the financial sector to avoid a new financial crisis. Instead, most of the work this time focused on harmonizing Swedish financial regulation to EU standards.

In 1996 the government issued a guarantee of bank deposits up to SEK 250,000. Similar guarantees were already in place in many European countries.

Instead of imposing new national regulation of banking risks after the crisis, the Swedish government began implementing the Basel rules. Since then, all major changes to Swedish legislation have been aimed at ‘adaptation’ to Basel II rules.

One notable exception concerns banking priority in the case of bankruptcies. In the 1990s, in cases of business bankruptcy, bank debt was settled first, ahead of all other debts. This was criticized heavily by small business organisations claiming that this priority had a detrimental side effect of encouraging banks to force businesses into bankruptcy unnecessarily. This in turn shifted financial problems onto suppliers, since banks’ debt were given priority. Thus, the suppliers could never collect on trade debts from these bankrupt businesses. The banks’ priority was claimed to create unnecessary chains of bankruptcies in this way.

After much debate, legislation was changed so that banks’ priority was limited to apply to only 55% of the bankrupt estate’s assets. Banks vehemently opposed this new rule and several reports were published, indicating that the new legislation made it harder for small businesses to obtain bank lending. After an animated debate where even different small business organisations were on opposite sides, the current centre-right government decided to raise banks’ priority again to include all company assets.

Deregulating historical monopolies

The Swedish economy’s competitiveness also became a priority. Economic growth had been lagging behind European countries for many decades. The 90s crisis only made reforms more urgent.

Now, many natural monopolies have been deregulated to a greater extent in Sweden than the European average. EU comparisons show that all European countries have opened their aviation and telecoms markets. Most countries, but not Sweden, still retain a partial monopoly for postal services (letters). About half of European countries have not yet fully opened their electricity markets to competition. Taxi regulation prevents entry in many countries, but not in Sweden.[11] Even railways are somewhat more liberalized in Sweden than in most European countries.

Nevertheless, several regulatory issues remain in these markets. This section briefly describes how Sweden has tried to tackle these issues, and related outcomes.

[11] (Bekken, 2003).

Media

Up to the late 1980s, radio and television were a state monopoly, though they were formally independent of the government. A common criticism, however, was that they were in practice dominated by journalists with leftist views, and commonly reported in what today would be judged as remarkably partial journalism. Gradually, this biased reporting has become more balanced.

A few unlicensed radio stations had begun operating in conflict with Swedish law, claiming freedom of speech, but under constant threat of being shut down. After 1991, entry was allowed for private radio and television, and eventually concessions were enacted for private channels.

Electricity

The electricity market was previously vertically integrated. The large producers regulated the market in various clubs under the chairmanship of the dominating state-owned Vattenfall. After deregulation in 1996, the market has been divided into three segments: generation, distribution, and trading firms. Only distribution firms are still regulated monopolies. In addition, the Nordic market has opened up, so exports and imports are easier. It is quite common now for trading firms to sell imported electricity directly to households. Consumers are billed separately by distributors.

One concern in the wake of deregulation has been that the larger groups have bought up small and medium-sized distribution firms. State-owned Vattenfall remains a dominant actor that has invested in other countries to an increasing extent.

Electricity prices are lower in Sweden than many European countries. One study of the effects of deregulation on both prices and costs, found that prices are indeed lower than they would be without deregulation.[12] The largest gains, from cost savings, have accrued to power producing companies and industrial customers. After an initial period of lower prices for households, these have ended up paying higher prices due to environmental taxes, higher demand, and integration of the Swedish electricity market with pricier markets in neighbouring countries.

Aviation

Aviation has been deregulated in the same way as in most European countries. The market is still dominated by SAS, which remains partly state-owned.[13] A considerable number of entrants have joined this market, while several of these have left again. Profit levels are generally low. The most important airports are owned by the central government, while many smaller airports are owned by

[12] Green and Damsgaard (2005).
[13] By the Swedish, Danish and Norwegian state.

local governments. In both cases, airports are not generally exposed to competition. There are complaints on how they charge fees for their services and allocate slot times.

Prices have risen faster than in the consumer price index since deregulation. But an international comparison seems to indicate that Sweden has about the same price level as many European countries for business travel, but lower prices for private travel (Luftfartsverket, 2004).

Rail Services

Previously the Swedish State Railway, SJ, was a monopoly. Now it is a carrier supposedly like any other, while the National Rail Administration operates the railway network. For goods traffic, entry is free but for passenger traffic SJ still dominates traffic deemed to be profitable. Non-profitable interregional and local traffic is procured by various authorities, often through competitive tendering procedures.

In the railway market, prices fell for transport of goods, but increased for passenger traffic, in particular for non-subsidized traffic. This is partly explained by the new train services that have started operating offer faster travel. Subsidized traffic has been tendered and seen smaller price increases. Some of the price increases are explained by the fact that the degree of subsidisation is lower – from 64% in 1990 to 42% in 2002. One study concludes that the most important competition to rail services has come from long distance bus traffic, which was also liberalized in the 1990s.[14]

Postal Services

The state-owned postal service, now merged with the Danish postal service, has been exposed to intense competition in the financial services and package delivery sectors. At the heart of the monopoly, however, was letter delivery. This has been opened to competition and up to one hundred firms entered. Only one firm, however, has been able to establish large-scale operations. London economics (2003) finds that Sweden has an average price level comparable to other European countries. Most European countries have also deregulated financial services and package delivery but retain a state monopoly in letter delivery. Swedish prices are considerably lower than the still regulated Norwegian prices.

Telecommunications

The market has gradually been opened to more players than the former monopolist, the partly state-owned TeliaSonera. TeliaSonera also operates most of the fixed nationwide network, but is required to allow access to other firms at regulated prices. Mobile services are provided by a number of

[14] Järnvägsgruppen (2003).

competitors that operate their own networks. An OECD comparison for the telecom market indicates that prices are relatively low in Sweden compared to other European countries.[15]

Other markets

Apart from network services there have been a number of other deregulations. One example is taxi services. Before deregulation, entry and prices were regulated. There were often queues for taxis. After deregulation, the number of taxi companies and drivers increased considerably but prices increased, too. Burdett and Fölster (1994) analysed the effects of taxi deregulation. They conclude that the decrease in waiting times of four minutes on average per trip was well worth the price increase given the estimated value that taxi customers placed upon reduced waiting time. Bekken (2003) concluded that Stockholm has relatively low taxi prices compared to other European capitals.

A government investigation conducted by the Regulatory Reform Commission (2005), attempted to summarise the effects of deregulation in telecoms, electricity, postal, domestic aviation, taxi and rail service markets. Their conclusion was that the number of firms increased in all deregulated markets. Productivity has increased faster after deregulation in at least four of the six markets.[16] A sign of this is also that employment has decreased in all markets except for taxi market.

When it comes to price changes, however, the Commission claims that prices increased relative to the consumer price index in five of the six markets. The only exception is the telecom market where prices have fallen substantially. This way of viewing pricing effects of deregulation seems to be at odds with the referenced studies above, which indicate that Sweden has relatively low prices in deregulated network markets. One explanation for these diverging conclusions is that many of the network markets have been subject to branch-specific cost increases. Electricity and aviation, for example, have had to absorb various environmental taxes. Rail services, in turn, have had to pay higher electricity prices. Further, prices in network markets have not increased faster than domestic services in general. This may be a more relevant comparison than the consumer price index, as such, since it is affected by falling prices for imported goods.

Another aspect, however, is that competition in network markets – even after deregulation – remains far from perfect. It may therefore be misleading to expect prices in network markets to follow the same pattern as in consumer markets where competition is unfettered. On average, consumer prices increased 2% per year the decade after deregulation, from 1994 to 2004. The partially deregulated

[15] OECD (2003).
[16] For example Falkenhall and Kolmodin (2004) show that labour productivity in the state owned postal firm (Posten AB) increased by 30% after deregulation between 1993 and 2000. Veiderpass (2004) shows that total productivity in the electricity supply industry fell by 16.9% from 1970 to 1995, but increased after deregulation by 19 %.

network industries reviewed above have seen price increases of 3% annually during this period. Finally, completely regulated branches, including healthcare and municipal services, have seen price hikes of 6% per year. While this is too crude for real comparison various studies confirm a link between the degree of competition and relatively lower prices. For example, Bergman (2004) plots the unexplained price differences (as in differences not involving labour costs, wage tax wedges, and consumption taxes) between Sweden and the EU against our competition index, and also finds a close correlation.

Local government policies

Local government is the main provider of welfare services in Sweden.[17] They produce and buy healthcare, schooling, eldercare, local transport as well as a wide range of cultural services. Municipalities and County Councils in charge of health care in Sweden provide public consumption amounting to close to a quarter of GDP. Of that amount, about 13% is purchased from private providers, up from about 4% in 1990. Unfortunately, there are no exact figures for how large a share of local government services is put up for tender. A rough estimate is that public providers win contracts in tendering in about half the cases. That would imply that approximately 80% of public consumption provided by local government is still not exposed to competition at all.[18]

Swedish municipalities and County Councils have increasingly privatized some activities, partly driven by a need to cut costs and increase efficiency. The gradual increase in competition for local government services has had some success. For example, costs for local bus services decreased considerably in the early 1990s as most municipalities began procuring these services in open tendering.[19]

A central motive for allowing private competition, however, was widespread dissatisfaction with the lack of choice among welfare service providers. Up to the late 90s, Swedes were not generally allowed to choose doctor, hospital, schools or old age care even among public providers. The right to choose was probably a more important demand than a desire for efficiency or variety.

The Social Democrats began to allow choice among public providers of welfare services in the late eighties. The market-oriented government elected in 1991 quickly introduced a voucher system for so

[17] Sweden's political system consists of 21 counties (län) and 290 municipalities (kommun).
[18] For example, Bergman (2004) calculates the remaining price difference for the thirty consumption categories that cannot be explained by differences in taxes, labour costs, the exchange rate and changes in demand. Rents, health care prices and prices for transport services explain a significant share of the remaining gap. See also, Braunerhjelm *et al.* (2002).
[19] Alexanderson, Fölster and Hultén (1998).

called 'free schools' (that is, privately owned and operated). Sweden has historically had only a handful of private independent schools that are financed through student fees. But these 'free schools', on the other hand, are not allowed to charge student fees – ensuring equal access. Instead municipalities have to compensate free schools with the same amount of funding per pupil as they budget for municipal schools. A variety of cooperative and for-profit free schools quickly cropped up. Several studies indicate that these voucher-funded schools have had a positive effect on academic achievement in surrounding municipal schools.[20] Competition among schools also exposed weaknesses in the grading system, which is gradually made more resistant to grade inflation.

Responsibility for eldercare was moved from the local health care districts to municipalities as of 1990. An increasing number of municipalities began to procure elder care services from the private sector. Several municipalities also began using a voucher or customer choice model for care of the elderly, where private alternatives are free to enter the markets and compete with the public alternatives.

Similarly, some County Councils began purchasing more health care provision from private firms. In Stockholm about 30% is purchased from private providers. But in some regions, the share going to private providers remains close to zero.

In addition, local governments provide considerable private consumption for which they charge households. Some of this is distributed through utilities such as water, local power distribution, waste disposal, parks, and road management. Sometimes these are produced by the municipal administration, sometimes in municipal companies, and sometimes they are procured from private firms. Municipalities also provide a significant share of rental housing, sports facilities, local transport, and libraries. Further, all municipalities have to some degree entered markets for private consumption normally provided by the private sector. Some municipalities operate stores or taxi services. Many operate cafeterias or restaurants. Many operate gyms that compete with private gyms. These services are often cross-subsidised.

Strategies for cutting red tape

Local governments play an important role in Sweden's public finances. Their expenditures amount to nearly 25% of GDP, and they also employ about a quarter of all Swedish employees. These are around double the comparable figures for the USA. Because of this significant economic role, tax, expenditure and regulatory policies of local governments can have significant effects on the private sector.

[20] E.g. Bergström and Sandström (2002, 2005).

In many municipalities, administrative procedures impacting private businesses have been speeded and simplified. According to some studies, these municipalities have also been rewarded with better growth rates in terms of employment, incomes and entrepreneurship (Fölster and Peltzman, 2009).

At the national level, governments of various colours have all had strategies aimed at cutting red tape, mainly for small businesses, since the crisis in the 1990s. But the results of these attempts remain unimpressive and far from achieving the goals originally formulated.

Role of competition policy

As discussed, Swedish competition legislation was completely revamped in the nineties. Competition policy had been rather lax in previous decades. Cartel agreements were legal until 1993. Firms were free to enter agreements on price fixing, market sharing, and allocation of retail outlets among manufacturers. Only resale price maintenance agreements and joint tendering on public contracts were prohibited.

Sweden's competition law was brought in line with EC rules in 1993. This included widening the applicability of the per se rule: Horizontal price-fixing and market sharing agreements became illegal regardless whether they could be shown to have negative effects. Fines were increased considerably. And then Sweden joined the EU in 1995.

The previously lax competition policy may have continued to have effects insofar as formally legal arrangements continued as informal arrangements in some cases. Several cartels of this kind have been uncovered by the Swedish competition authority in recent years. There were over one thousand cartel agreements registered in 1990, which impacted approximately 15% of total sales of goods and services[21]. One analysis of the Swedish manufacturing sector for the period from 1976 to 1990 was able to discern considerable economic effects of registered cartels (Fölster and Peltzman, 1997). A key result was that both price and environmental regulation raised prices considerably. Once the effect of regulation was taken into account, the registered cartels contributed little to higher prices. However, cartels were found to have a substantial negative effect on output. It should be noted, however, that output was much more accurately measured than prices.

Evidence of how important the sea change in competition law has been may not be entirely conclusive.[22] At the very least, however, changes in competition law facilitated a wide range of deregulation. Entry has become easier in a number of areas from financial services to retail stores and

[21] SPK (1992).

[22] An empirical assessment of U.S. antitrust policy claims that its beneficial effects for consumer welfare may have been negligible (Crandall & Winston, 2003).

chimney sweeps. In retail trade (except for food shops), foreign chains have entered the market on a large scale and now hold considerable market share in many cases.

The new competition legislation had an important impact on recovery from the crisis in the short and medium term as well, since it allowed the central bank to keep interest rates lower. Sweden's price levels were roughly 40% above the OECD average in 1990 (corrected for GDP levels). By 1994 this had fallen to about 15% above the GDP-corrected OECD average[23].

Prior to 1992 the implied subsidies to food production in Sweden (through protection) were even higher than in the EU. Entry at the food retail level was also subject to municipal zoning regulation, which was often used to protect the larger Swedish chains. These restrictions were abolished in 1992, but reinstituted in 1996. In the meantime, however, many municipalities had changed local policies leading to a gradual increase in market share for low-price retailers. Further, new food store chains and foreign chains have entered the market, albeit on a small scale. The Swedish Competition Authority found that in the period 1997-2000 municipalities with a strict implementation of zoning regulation in fact had less food stores per inhabitant, and that more liberal implementation appeared to lower food prices.[24]

There seems to have been a remarkable impact of reforms on prices. Figure 11 below shows how consumer prices for food have increased less than the general price index since 1991 when competition increased through deregulation and subsequently through EU membership. International price differences are not merely determined by differences in regulation, protection, and competition policy but also by country differences in per capita income, indirect taxes, and wage dispersion.[25] Bergman (2004), in a more recent study, finds that Swedish food prices are no longer higher than in the EU once differences in labour costs, wage tax wedges, and consumption taxes are taken into account.

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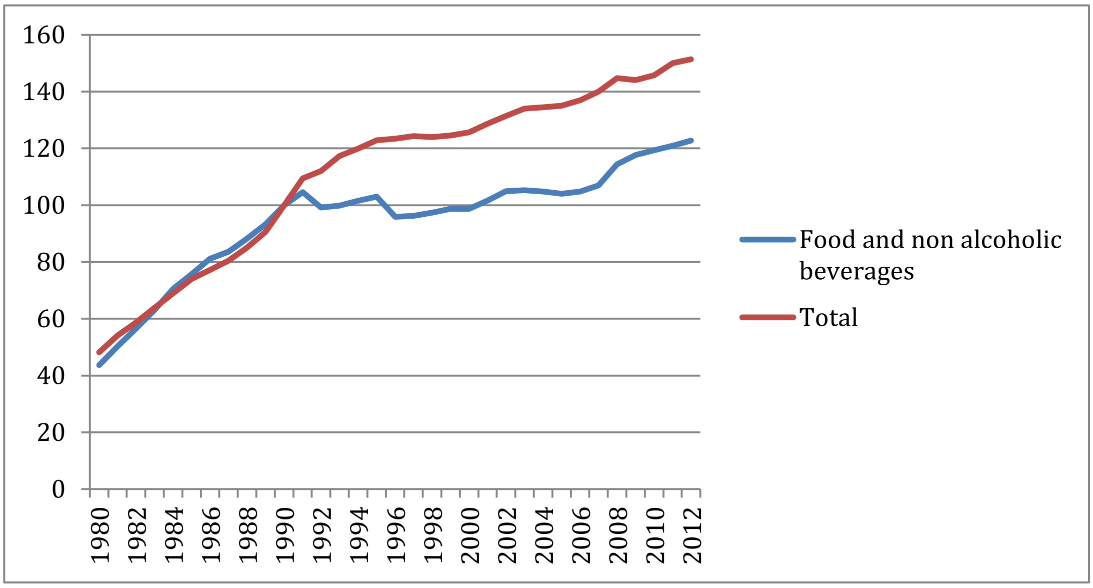
[23] See Folster and Peltzman (2009) for the exact calculation.
[24] Lundvall and Odlander (2001).
[25] Lipsey and Swedenborg, 1996, 1997.

Figure 11. Swedish consumer prices for food and total, index 1990 = 100 .



Source: Statistics Sweden

A lack of competition may not be the primary cause of the remaining price gap shown between Sweden and many other countries. The Swedish Competition Authority has recently analysed relative price levels at the macro-level.[26] Their conclusion is that about half the difference between Swedish and OECD price levels can be explained by population size, GDP per capita, tax levels, labour costs, consumption patterns, and exchange rates. Average value added tax rates of 22% in Sweden are considerably higher than in most countries.

Trade Policy

Despite the severity of the 1990s crisis, the government did not impose any protectionist regulation and there was no strong political pressure to do so either. On the contrary, political efforts concentrated on liberalizing trade. Firstly, policy makers decided to apply for EU membership in 1990. The new government entering office in 1991 was also determined to join the EU. Of course, the changes made necessary by this membership bid lead to greater opening of markets to foreign competition.

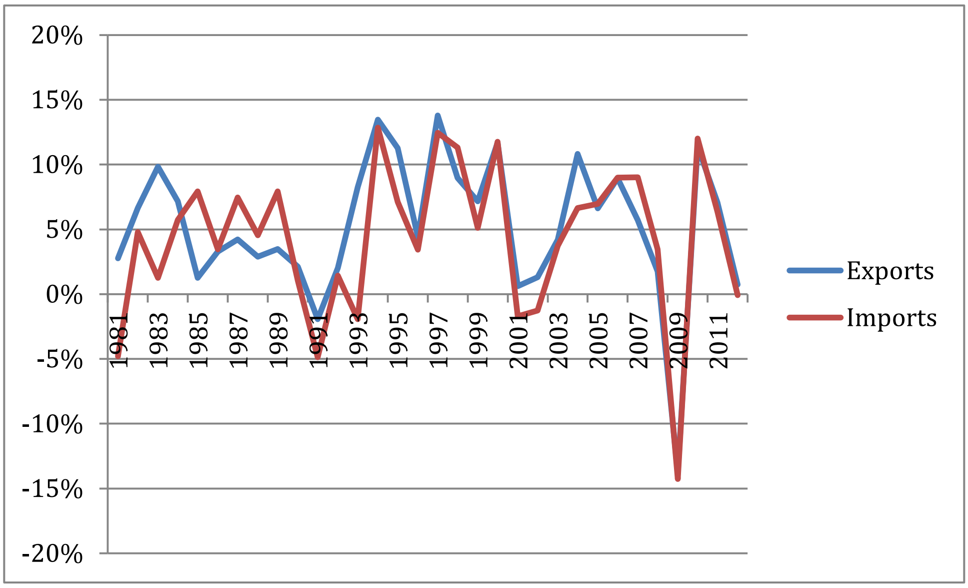
Secondly, negotiations in the Uruguay round were in their final stages when the 1990s crisis broke. But, though many large Swedish manufacturing companies experienced great difficulties then, they

[26] For example in Konkurrensverket (2000).

still wanted the Swedish government to work for as much trade liberalisation as possible in the negotiations.[27]

In the end, it was increased trade that made recovery in the mid-1990s possible. The fall of the Swedish krona led to rapid growth in Swedish net exports. However, it is important to note that this growth in net exports was not simply due to slower growth of imports. Rather, both exports and imports grew much faster than during the eighties.

Figure 12 Yearly growth of exports and imports



Source: National Institute of Economic Research.

In conclusion, it is clear that trade policy became more free trade-oriented in the 1990s crisis. Swedish policy makers, from almost every political party, had long been pro free trade. Therefore, economic downturns seldom lead to political demands for trade restrictions. If anything, the crisis may have influenced the outcome in the referendum on EU-membership in 1994 and thereby lead to more international competition. The issue of whether membership would influence the Swedish economy in a positive or negative way was the most important for Swedish voters. In the year leading up to the referendum 54% of Swedish voters thought that membership in the European Union would benefit the Swedish economy. Just four years later only 15% of Swedes made the same assessment[28].

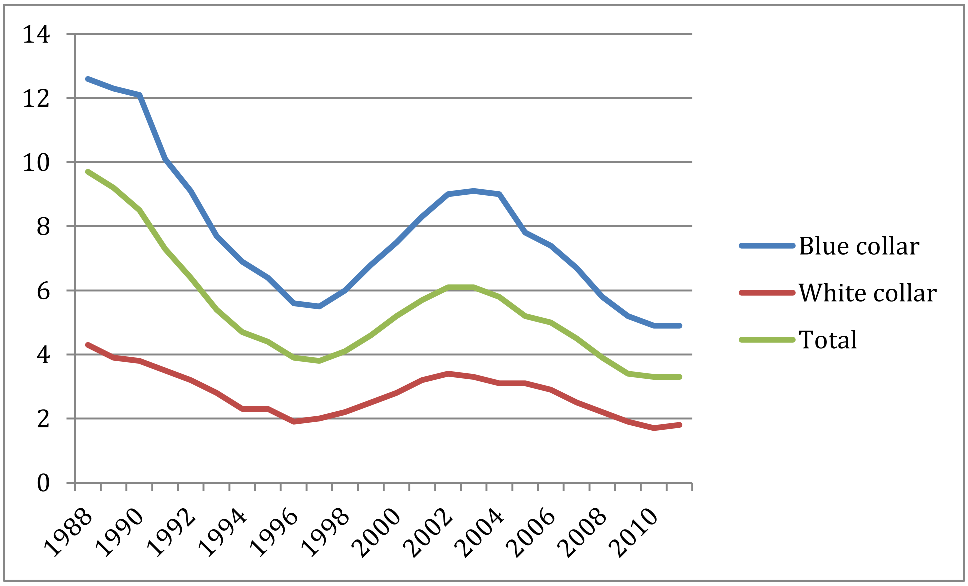
All evidence indicates that the wave of reforms in the nineties has had a tremendous importance for Sweden. One would therefore expect that further reform work would have been pursued by Swedish policy makers. Instead reforms came to a virtual halt and picked up only from 2006 to 2010, partly stimulated by a dramatic rise in absence from work. An exception was abolishment of the inheritance

[27] Interview with Göran Noren, former head of Trade Policy Department at the Federation of Swedish Industries, August 13 2009.
[28] Lindahl R. (2004).

tax by the Social Democratic government in 2004, motivated largely by the fact that many small firms experienced great difficulty in managing generational succession. Also, revenue from inheritance tax was limited because many of the larger fortunes had long since moved out of the country.

A sudden increase in sick leave became a primary economic challenge in the beginning of 2000, even though it was still lower than during the heyday of generous welfare in the 1980s. This became the main focus of political attention and helped the market-oriented parties to win election in 2006.

Figure 16. Sick leave in percentage of ordinary working time



Source: Ekonomifakta

It was expected that the new alliance government, elected in 2006, would implement a new wave of strong reforms. Even though growth had picked up in Sweden, there was still room for vast improvements. Taxes were high in an international perspective and entrepreneurship is lower than in many other countries.

The new government did start out implementing several major reforms. Benefits were cut and taxes on wages and salaries were reduced with an earned income tax credit. This tax deduction is phased in at lower incomes and phased out at higher income levels. This tax deduction does not apply to non-work income such as unemployment benefits.

Other important reforms included abolishing the wealth tax, adding a tax deduction for household services, and reducing payroll taxes for youths and elderly. A feature of many reforms was to implement a series of smaller reforms, or to introduce larger reforms in smaller steps. The Reform Institute has listed the most important reforms from a growth perspective since 2007.

Table 1 Reforms with greater impact on growth or employment 2007-2012.

Year 2007	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012
Introduction of the Earned Income Tax Credit	A second step of the Income Earned Tax Credit	Free entry for providers of primary care	The minimum capital requirement for limited companies is lowered		Lower VAT on restaurants
The Wealth Tax is abolished	Gov't monopoly on OTC drugs abolished	The state monopoly on prescription drugs is abolished	A fourth step of The Income Earned Tax Credit		Reforms of the rules concerning owners of small companies
Lower taxes on Owners of Small Businesses	Relaxed Labour immigration	Corporate tax lowered to 28,5 %	Auditing becomes voluntary for very small firms		
Tax deduction on purchases of household services		A third step of The Income Earned Tax Credit	Lower payroll taxes for self employed		
Easing on the use of temporary employment		Lower payroll tax			
Co-financing of sick pay is abolished		Reforms of the competition law			
Lower income tax for the elderly		A higher limit at which state tax is paid			
Easier rules for VAT-payments		Additional reduction to payroll tax for young employed			
Lower unemployment benefits		New law permitting free entry of old age care providers in some municipalities			
Reforms of the rules concerning unemployment benefits		Reform of tax rules for owners of small businesses			
Lower payroll taxes for young persons employed					

Source: The Reform Institute of Stockholm.

During 2013 the following reforms were implemented:

Year 2013
Subisidies to apprenticeships
Subsidies to teacher career steps
Additional earned income tax credit
Tax reduction for R&D personell
Tax reduction for investment in start-ups
Subsidized training/employment for youth

Source: The Reform Institute of Stockholm.

Even if some important steps have been taken towards making Sweden a more competitive economy, it is evident that the pace of the reform slowed considerably after 2010. Paradoxically, this coincides with many other countries stepping up their reform efforts to combat the financial crisis. Reasons for this apparent indifference to reform now include the fact that the centre-right government lost its majority in parliament and must obtain opposition support for any legislation, and that Sweden seems to be doing well compared to other countries, so public pressure for further reform is subdued.

Corporate tax rates have been cut to a rate of 22% as of 2013. Further, the national sick leave coverage kicks in sooner for self-employed, and public R & D spending has been increased. A tax deduction will be introduced for private investors that invest in new firms at the end of this year.

For 2014 the government implemented at a fifth extension of the earned income tax credit.

One indication there still is room to improve the business climate in Sweden is the World Bank's ranking of 'Ease of doing business'. Sweden is currently ranked 13 in *Doing Business*, which indicates further reforms are possible. But more worrying is that the reform pace in Sweden is slower than in most other countries. World Bank measures the reform pace by calculating the distance to the frontier. In this case, the frontier consists of the country ranked first in each category. The average improvement measured in this way was 5.7 percentage points between 2006 and 2011. But there were large differences between different regions of the world. In Sweden, the improvement was 2.9%. In the EU/Efta improvement was 3.4%. Measured in this was way, the average pace of reforms worldwide has been twice the pace in Sweden.

This probably also explains why Sweden, in spite of all the reforms discussed above, has not regained its fourth place in terms of GDP per capita among OECD countries that it held in the early 1970s. Several other countries have simply reformed even more than Sweden and have reaped the benefits of their efforts.

Conclusion

This report describes the history of reforms implemented in Sweden from the early nineties onwards. In the 1990s, the entire tax system was reformed, a public expenditure ceiling was put in place, collective wage bargaining found an entire new form, Sweden entered the EU, state owned monopolies became subject to competition and the fixed exchange rate was abolished. Moreover, privately owned companies were allowed to start schools and enter healthcare markets. Also, completion legislation was strengthened thereby reducing the number of cartels and their impact.

The results of this wave of reforms are remarkable. During the twenty years before 1995, GDP and productivity growth was substantially lower than in other countries. Virtually no net jobs were created in the private sector and government debt increased rapidly. Moreover, disposable income of Swedish households grew only in a very slowly.

Since 1995, every aspect of the Swedish economy has changed. GDP and productivity growth have been higher than in comparable countries. Employment in the private sector has grown by more than 1% annually, while public sector employment has decreased. Public finances are now stronger than in most countries. Furthermore, median disposable income of Swedish households has grown 4 times faster after 1995, compared to the previous 20 years.

One would expect that these results would induce further efforts from policy makers to continue reforming the Swedish economy. Much room for improvement remains. Unemployment in youth and immigrants remains high, and growth has slowed considerably in recent years. Despite these indicators, as we showed in the concluding section of this paper, the pace of reforms in Sweden has slowed considerably. In particular, Sweden’s reform efforts in last five years have slowed to half the world average and lag behind the pace in the rest of Europe.

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