WebMemo
Published by The Heritage Foundation

No. 1219
September 21, 2006

Hoping to Restore Growth, Voters Rebel Against Sweden's High-Tax Welfare State

Daniel J. Mitchell

In a stunning setback, Sweden's Social Democrats were ousted from power in Sunday's election after receiving their lowest share of the vote since 1914. This result is somewhat surprising since Sweden, at least by European standards, is experiencing decent economic growth and modest levels of unemployment.

A closer examination, however, reveals that the famous "Swedish Model" does not work very well. This system, which combines high taxes and a large government sector with *laissez-faire* policies in other areas, is supposed to generate strong growth while also providing protection against the vicissitudes of a market-based economy.

This system may work better than the "Continental Model" of across-the-board big government, which has caused stagnation in places like France and Germany, but it is not a recipe for economic prosperity. In 1970, Sweden was the world's third-richest nation, but it has fallen in the rankings as the welfare state has expanded.[1] Indeed, Swedes now have less per capita disposable income than the average Western European and also trail the U.S., Canada, and several Pacific Rim nations.[2] And, although the official jobless rate is about six percent, independent estimates suggest the real unemployment rate is between 15–20 percent.

With stagnant incomes and a weak job market, it is not surprising that Swedish voters chose a new government. It remains to be seen, however, whether the incoming coalition of center-right parties is able to deliver the change Sweden needs.

Sweden's Costly Welfare State

With government spending consuming nearly 54 percent of GDP,[3] Sweden has the biggest burden of government in the developed world. Not surprisingly, a bloated government also means high taxes. Taxes consume nearly 55 percent of GDP, also a record for industrialized nations.

The top personal income tax rate is about 57 percent, which is punitively high, though not as bad as the 87 percent top tax rate that existed as recently as the late 1970s. Payroll taxes also are a significant burden, totaling nearly 40 percent of income, including a 32.28 percent tax imposed on employers. Wealth is taxed, as are capital gains. And, just in case a taxpayer has any disposable income left after paying all these taxes, the value added tax is 25 percent, the maximum rate allowed for European Union nations.

Sweden's tax policy is not entirely punitive. The corporate income tax is 28 percent, which is not terribly high by world standards. Moreover, Swedish policymakers earlier this decade eliminated the nation's

This paper, in its entirety, can be found at:
www.heritage.org/research/taxes/wm1219.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

death tax. But, these positive features are in no way enough to offset the economic damage caused by the high tax rates elsewhere in the Swedish system.

High Joblessness and Low Living Standards

Sweden traditionally has been a prosperous nation. During the early part of the 1900s, the burden of government was low, and *laissez-faire* economic policy helped create a prosperous nation. Sweden also benefited by avoiding involvement in World War II, which meant it was well-positioned to prosper in the post-war environment, particularly since the aggregate tax burden at the time was about 20 percent of GDP, comparable to the tax burden in Hong Kong today.

Unfortunately, the subsequent expansion of the welfare state chipped away at Sweden's competitiveness. By 1980, the aggregate tax burden had climbed to more than 50 percent of GDP, and tax rates had reached confiscatory levels. Excessive levels of government spending compounded the economic damage by misallocating labor and capital.

Not surprisingly, bad policy had an effect on Sweden's economic performance. As mentioned above, Sweden is no longer one of the world's 10 richest jurisdictions. It now ranks as the 18th most prosperous nation according to the World Bank,[4] which uses per capita gross national income. Using statistics that more accurately measure living standards, such as per capita disposable income, Sweden falls even further in the rankings. According to calculations by the OECD, Swedes now have less disposable income than the average resident of Western Europe. Even Spaniards now rank above Swedes in terms of per capita disposable income.[5]

Americans, meanwhile, have almost twice as much per capita disposable income as Swedes, according to the OECD study. Even if the comparison is made using pre-tax economic output, America remains far ahead. Indeed, a Swedish think tank issued a report noting that if Sweden were part of America, it would be the sixth poorest state.[6]

Employment statistics paint an equally grim picture. The jobless rate was traditionally very low in Sweden, averaging about two percent. Over the past two decades, however, the official unemployment rate has more than tripled,[7] and the official numbers almost certainly undercount the true rate of unemployment. The McKinsey Global Institute estimates that the real unemployment rate is 15 percent.[8] A former Minister of Labor for the Social Democrats was even gloomier, admitting that the jobless rate may be in the 20–25 percent range.[9] A researcher for the nation's main trade union estimates the real unemployment rate is 20 percent,

---

1. Gronigen Growth and Development Centre, "Historical Statistics for the World Economy: 1-2003 AD," Table 3: Per Capita GDP, at *http://www.ggdc.net/maddison/Historical_Statistics/horizontal-file_2006.xls.*
2. Organisation for Economic Cooperation and Development, National Accounts of OECD Countries, 2005, and OECD Economic Outlook, No. 76.
3. International Monetary Fund, Sweden: 2005 Article IV Consultation, IMF Country Report No. 05/343, September 2005, at *http://www.imf.org/external/pubs/ft/scr/2005/cr05343.pdf*.
4. World Bank, World Development Indicators Database, GNI Per Capita 2005, July 1, 2006, at *http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf*.
5. Romina Boarini, Åsa Johansson and Marco Mira D'Ercole, "Alternative Measures of Well-Being," Organisation for Economic Cooperation and Development, Economics Department Working Papers No. 476 , February 2006, at *http://www.olis.oecd.org/olis/2006doc.nsf/43bb6130e5e86e5fc12569fa005d004c/407e59fce61acd81c125710d003d6c67/$FILE/JT00200315.PDF.*
6. Fredrik Bergstrom and Robert Gidehag, "EU versus USA," Timbro, June 2004, at ***http://www.timbro.com/euvsusa/pdf/EU_vs_USA_English.pdf***.
7. Eurostat ,"Unemployment Rate – Total," at *http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em071.*
8. David Ibison, "Real Swedish Jobless Rate 15%," *Financial Times*, June 15, 2006, at *http://www.ft.com/cms/s/c18430e6-fc0b-11da-b1a1-0000779e2340.html.*

and a senior fellow at a Brussels-based think tank notes that "not a single net job has been created in the private sector in Sweden since 1950."[10]

Rejuvenating Sweden's Economy

With such dismal numbers, it is not surprising that Swedish voters decided to oust the incumbent government. It is not clear, however, that this will lead to a change in policy. The leader of the newly-elected center-right alliance was deliberately vague about reforms and openly embraced the welfare state.

Sweden has engaged in dramatic reform in the past, so there is some hope. Not only did lawmakers abolish the nation's death tax, but the top tax rate is now about 30 percentage points lower than it was 25 years ago.[11] Swedish policymakers have also partially privatized the country's social security system,[12] and Sweden has an impressive school choice system based on vouchers.[13]

Combined with a *laissez-faire approach* to trade and regulation, these reforms have enabled Sweden to outperform some of Europe's more statist countries. But, if Sweden hopes to regain its position as one of the world's richest nations, it needs to return to the small-government policies that allowed it to grow so rapidly in the years before the welfare state wreaked so much havoc.

Daniel J. Mitchell, Ph.D., is McKenna Senior Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

9. Margit Silberstein, "LO: Regeringens siffror ljuger - arbetslösheten 20-25 procent," Dagens Industri, March 16, 2005, at *http://di.se/Nyheter/?page=%2fAvdelningar%2fArtikel.aspx%3fArticleID%3d2005%5c03%5c16%5c137054%26words%3dhans%2ckarlsson*.
10. Johan Norberg, "Swedish Models," *National Interest*, Issue 84, June 2006, at *http://www.nationalinterest.org/Article.aspx?id=11488*.
11. Sven Larson, "The Swedish Tax System: Key Features and Lessons for Policy Makers," *Prosperitas*, Vol. VI, Issue II, June 2006, at *http://www.freedomandprosperity.org/Papers/sweden/sweden.shtml*.
12. Goran Normann and Daniel Mitchell, "Pension Reform in Sweden: Lessons for American Policy Makers," Heritage Foundation *Backgrounder* No. 1381, June 29, 2000, at ***http://www.heritage.org/Research/SocialSecurity/bg1381.cfm***.
13. Johnny Munkhammar, "Hot Swedish Models," *TCS Daily*, March 1, 2006, at *http://www.tcsdaily.com/article.aspx?id=030106D*.