The Swedish Model Betrayed

Timothy A. Canova
Without the bulwark of full employment, the Social Democrats may well soon resemble their liberal adversaries. Joblessness will be tolerated, but with a kinder, gentler pink slip.

Olof Palme, Sweden’s former Prime Minister who dominated Social Democratic politics for two decades, is often remembered for his efforts on behalf of mutual disarmament and human rights. But, throughout the early 1980s, Palme stood out on the international stage as one of the leading opponents of the emerging neoliberal agenda. Financial deregulation, monetarism, and fiscal austerity, he warned, were a prescription for a society of “egoism and sharp elbows” and a threat to Sweden’s model of mixed market capitalism and universal social welfare.

More than any other recent Swedish political leader, Palme recognized the central importance of full employment in maintaining political support for Sweden’s “cradle-to-grave” welfare state. “Unemployment was not only an economic waste and an individual tragedy,” he said, “but also a threat to the open, democratic society.” For the better part of half a century, the hallmark of the Swedish model was an unemployment rate that rarely rose above 2 percent—an achievement unparalleled in a capitalist economy. Today, however, there are sharp elbows in Sweden. The unemployment rate now exceeds 13 percent, and the country is mired in its most profound recession since the Great Depression of the 1930s.

From 1932 to 1976, the Social Democrats governed with the support of the powerful Swedish Labor Confederation (LO) and pursued a relatively easy monetary policy that permitted low real interest rates and a steady expansion in aggregate demand, national income, and production. To keep the lid on cost-push inflationary pressures, the Social Democrats relied on the discipline and self-restraint of organized labor. LO’s wage solidarity policy (essentially an incomes policy) limited the rate of wage increases to the annual growth in productivity. However, by the 1980s, the very foundation of this incomes policy, Sweden’s system of centralized wage bargaining, was undermined by the powerful Swedish Employers Confederation (SAF).

The golden years

Throughout the golden years of Swedish prosperity, the government used other policy tools to keep the lid on demand-pull inflationary pressures, particularly a tight fiscal policy and selective credit controls—both of which were designed to slow economic activity without raising interest rates. (The ideas of the “Stockholm School” of economists, which anticipated those of Keynes, provided theoretical justification for centralized controls on credit and finance. In *The General Theory of Employment, Interest, and Money*, Keynes wrote, “The acuteness and peculiarity of our contemporary problem arises, therefore, out of the possibility that the average rate of interest which will allow a reasonable average level of employment is one so unacceptable to the wealth-owners that it cannot be readily established by manipulating the money supply... the rate of interest is not self-adjusting at a level best suited to the social advantage but constantly tends to rise too high, so that a wise Government is concerned to curb it by statute [i.e., usury laws and restrictions] and custom and even by invoking the sanctions of the moral law.”)

This strategy, which captured the essence of the Nordic character of collective self-discipline, was
enforced by a public bureaucracy strictly accountable to parliamentary control in order to achieve broad public policy objectives while limiting private excess. However, the intricate system of credit restrictions and interest rate regulations came under sustained attack from the neoliberal free market forces.

By the 1970s, Sweden’s living standards and per capita income were among the very highest in the world. However, after the 1976 defeat of the Social Democrats, significant cracks in the Swedish model became apparent. By 1978, a series of weak nonsocialist governments began to accommodate the market pressures for liberalization by abolishing controls on bank deposit rates, and in 1980, by removing the regulatory limits on interest rates for private bonds. (See “To Each According to His Greed” in For Further Reading.) As leader of the political opposition, Palme was one of the few who resisted this rush to liberalize. He criticized the policies of tight money and high interest rates which were fueling stagflation in both the United States and Great Britain. “It seems to me,” Palme said in 1980, “that governments all over the world should think more than once before joining the monetarist experiment.” (See “Democratizing the Economy” in For Further Reading.)

Free market agenda

But a government thinks and functions only through the people who staff its branches and agencies. Those people, while capable of “thinking more than once,” are also subject to subtle pressures, material incentives, and confusing distraction. After the Social Democrats were returned to power in the 1982 elections, Prime Minister Palme appointed his long-time party ally, Kjell-Olof Feldt, as Minister of Finance. If it was hoped that Feldt, who was schooled in neoclassical economics, would act as Palme’s spokesman to an increasingly econometric policy establishment, it is now apparent that Feldt’s major role was to translate the free market agenda into Social Democratic policy. The Finance Minister soon proposed the appointment of his former assistant, Bengt Dennis, to head Sweden’s central bank, the Riksbank.

Through such appointments, Palme was quickly surrounded by a powerful clique that came to be known as the Cabinet Right—men committed to bringing the free market agenda of financial liberalization to Scandinavian soil. The Finance Ministry, traditionally the watchdog of the private commercial banks, soon became their lapdog. Under Dennis, the Riksbank was transformed from something of a dormant, backwater institution (a mere arm of the governing party of the Swedish Parliament) into an autonomous political force. It relentlessly advanced the agenda of deregulation and monetarism. Prior to his appointment, Dennis had been editor-in-chief of one of the country’s largest daily newspapers, the liberal Dagens Nyheter, which was owned by the powerful Bonnier family. Dennis’s own power within Sweden was soon strengthened by his position on the Board of Directors of the Bank for International Settlements (BIS) from 1982–89, and as BIS president and Chairman of the Board from 1990–93. Throughout Dennis’s long tenure, the BIS, headquartered in Basel, Switzerland, played a leading role in the worldwide monetarist drive for central-bank autonomy and zero inflation. (See “Presenting John Crow’s Boss” in For Further Reading.)

By the early 1980s Prime Minister Palme was under increasing pressure, both from the outside and within his own government, to abolish Sweden’s long-standing system of financial controls. Each small step to deregulate brought greater pressure to bear on the foundations of the regulated regime. According to Feldt’s recently published memoirs, by November 1985, the Riksbank was pushing Palme to abolish the last remnants of domestic credit regulations—the ceilings on housing loans from banks and finance institutions. Traditionally, the government used such credit restrictions to slow down an economic expansion, without raising interest rates, simply by limiting the amount of credit allocated to housing. Feldt tried to assure the Prime Minister that this was the final logical step in the government’s policy of deregulation, part of its “Third Road” between austerity and debt-driven consumption. Just when Feldt thought that Palme would say no to this demand, the Prime Minister, worn down by fatigue and distracted by other political matters and affairs of state, threw up his hands and said, “Do as you please. I don’t understand anything anyway.” It was the only time that Feldt had ever heard Palme make such a pronouncement. The Palme government had joined the monetarist experiment. (See All the Days in the Government: 1982–90 in For Further Reading.)
But, of course, this was not, as Feldt had promised, the final logical step in the deregulation process. The banking establishment, emboldened by its victory, clamored for more. Its sights were already set on the foreign exchange markets. As Feldt now recognizes, the political implications of Palme’s November 1985 decision were monumental. Social democracy, after decades of unyielding resistance, had finally handed over one of its most symbolic bastions for directing the Swedish economy to the market forces: “It was a concession to the neoliberal ideology that we Social Democrats had devoted so much effort to fight.” Ingvar Carlsson, Palme’s Deputy Prime Minister and eventual successor, has also admitted, “We were all under strong pressure from the Riksbank and the banks: ‘Do it; we will handle it.’” As time would tell, the banks did not handle the fallout—that is, not without considerable public assistance.

The assassin’s bullet

On the night of February 28, 1986 (his secret service protection having been called off for the evening), while strolling along a busy Stockholm avenue with his wife, Olof Palme was gunned down by an unknown assassin wielding a .357 Magnum revolver. Shot in the back, the 59-year-old Prime Minister died within minutes on the cold, snowy sidewalk. The following morning, Swedes awoke to the news and to the realization that their progressive society was no longer isolated from the same hostile forces that threatened the rest of the world.

Only a month after Palme’s burial, the Governing Board of the Riksbank presented an important report that publicly called for the complete elimination of Sweden’s long-standing system of foreign exchange controls—the transnational policy analog to the domestic credit controls, which had been abolished just four months earlier. The new government, then headed by Carlsson, accepted the Riksbank plan: Sweden’s foreign exchange restrictions, which had been in place for more than forty-five years, were completely phased out by 1991. (See The Flight of International Capital: A Contemporary History in For Further Reading.)

The Carlsson government

The Carlsson government soon found itself incapable
banks with loans on special terms to stabilize confidence in the financial system, a reduction of interest rates on those indebted to the banks would have produced the same results by lowering the default and foreclosure rates, and strengthening the loan portfolios of banks.

Of course, this was all sheer madness. Speculation had become the tail wagging the dog of economic activity. The high interest-rate policy ultimately failed to sustain the value of the currency, and the Riksbank finally capitulated, allowing the krona to depreciate and float, but not before severe damage was done to the economy. This ended the policy of pegging the krona to the European Currency Unit (ECU), which was started on May 17, 1991, after the Parliament had authorized the government to apply for membership in the European Community. Swedish businesses reeled under the financial burden, paying 20-30 percent interest rates, at a time when their sales, prices, and revenues were all flat. The empirical record clearly demonstrates the dramatic rise in real Swedish interest rates throughout the 1980s—partly a result of interest rate deregulation, and partly a result of the increased reliance on monetarist policy solutions to "stabilize" the economy. The real market yield on long-term Swedish government bonds more than tripled, from an average of 1.55 percent for the 1970s to more than 5.02 percent throughout the 1980s, and 5.57 percent today. While the resulting economic stagnation was predictable, its magnitude was alarming. In little more than a year, more than a quarter-million manufacturing jobs disappeared in a country of eight million.

Sweden's very high real interest rates have also contributed to a massive redistribution of wealth and income from consumers—largely a debtor class comprising the majority of Swedes—to the minority of creditor interests and elite Swedish families. This ongoing redistribution has quietly undermined domestic demand, dragged down mass purchasing power, and thereby discouraged investment. Meanwhile, the government's annual expenditure on interest on its debt is now the highest in the industrialized world. This has pushed the budget deficit to an unheard-of 14 percent of GDP. Moreover, on a per capita basis, the scale of Sweden's commercial banking bailout rivals any nationalization program in history. (The government now effectively subsidizes the earnings of the banks by permitting an unprecedented interest rate differential between the banks' lending and deposit rates ranging from 7 percent to 10 percent.)

**Had Palme survived**

The sharp-tongued Palme had been a towering figure on the Swedish political landscape for as long as many could remember—at least since 1968, when he was elected Europe's youngest Prime Minister at the age of 42. With his sudden death, a political vacuum developed in which dimmer lights were allowed to shine. Now, with Sweden's unemployment rate at record double-digit levels, the public debate has shifted dramatically to the right. It is now more common to blame the present crisis on "forty years of socialism" than on the more recent, and more significant, free-market excesses and failures of the neoliberal experiment. Immigration restrictions, cutbacks in public services, a schedule of privatizations, and Riksbank "autonomy" have replaced yesteryear's agenda of universal entitlements, comprehensive maternity/paternity leave, public tuition financing for higher education, workplace democracy, and employee control of industry and finance through the creation of collective wage-earner funds. Instead of Palme's far-reaching policy of Swedish "integration" with an emerging social democratic Eastern Europe and the newly freed Baltic states with the potential for a wider, transnational, employment-oriented trade and currency union, there is now only the prospect of Swedish membership in a corporatist European Economic Community, in which the German Bundesbank dominates the currencies of the peripheral jurisdictions. As Palme had once warned, the price of the Riksbank's monetarist experiment would be high indeed.

Many Swedes are still reluctant to ask themselves whether the assassination of Olof Palme was such a watershed event, or whether any one person could really make a difference in an increasingly bureaucratic world. But there are still those who remember Palme at his best, as an intelligent politician willing to question liberal doctrine and dogma. The more thoughtful Swedes, even those who harbor disappointment with Palme for his Cabinet Right, admit that Palme would never have tolerated today's high
levels of unemployment. In the final analysis, they say, Palme’s own ego would not have permitted him to preside over such joblessness. When the storm came, Palme would have realized that it was time to “think more than once”—to question anew the underlying monetarist premises of deregulation. He would have shaken off the fatigue, broken through the distractions, brought in his advisors—the same LO advisors who had warned of the impending peril—and he would have sat them down and said simply: “Tell me again.”

Had he lived, Palme most certainly would have had at least two opportunities to reconsider his November 1985 decision to abolish domestic credit regulations. The first would have presented itself when the Riksbank made its demand to abolish Sweden’s exchange controls; the second opportunity came when the Riksbank tightened credit in 1991 to slow the economy, thereby raising interest rates, bringing on recession, and doubling the unemployment rate to 3.5 percent by the end of the year. As if that would not have been enough, still to come were the triple-digit interest rates, record double-digit unemployment, and the twin embarrassments of economic collapse and political failure.

The economic crisis has now eroded public support for the Moderate-led government. At this time, Carlsson’s Social Democrats lead in the polls and are favored to win next September’s elections. But Carlsson has largely accepted the fundamental premises of liberalization. His idea of “rethinking” economic issues is to reject any return to currency regulation as simply impossible. There is no turning the clock back, Carlsson has said. He has all but admitted that full employment is a mirage receding into an uncertain and distant Swedish future.

But, without the bulwark of full employment, the Social Democrats may well soon resemble their liberal adversaries. Joblessness would be tolerated, but with a kinder, gentler pink slip. Such a platform may win an occasional election, but that doesn’t make for effective, long-lasting government and public support. That a 13-percent unemployment rate has not led Sweden’s once great Social Democratic Party to question the mantra of deregulation suggests that the party has surrendered not just its heart and soul, but its willingness to think and rethink and, once again, search for a way to turn the clock ahead to a more disciplined and prosperous time.