

Erik Moberg:

The Swedish Model: A Comment on Mancur Olson's Analysis

This essay appeared originally in Olson, M & Kähkönen, S (ed), *A Not-so-Dismal Science - A Broader View of Economies and Societies*. New York: Oxford University Press, 2000.

This is a facsimile version.

© Oxford University Press

The Swedish Model: A Comment on Mancur Olson's Analysis

Erik Moberg

1 The Rise and Decline of the Swedish Model

For a long time in this century many Swedes were proud of their country. From a relatively poor and backward position, it developed into one of the three or four most productive economies in the world. At the same time, the Swedish welfare state gradually took form. The public systems of education, medical care, and other social services grew. Poverty was almost entirely eradicated and people's standard of living, while growing, became more and more equalized. At the end of the 1960s, the public expenses constituted about 45 percent of the GDP, and there were no deficit problems. Internationally, *the Swedish model* became a concept loaded with positive values.

The 1960s were the heyday of that model. Then, gradually, things started to deteriorate. Sweden's growth rate became slower and in some years, the latest of which are 1991, 1992, and 1993, even turned negative. The production per capita is now below that of at least fifteen other industrialized countries. Unemployment has risen dramatically.¹ The retarded growth has been accompanied by continuously increasing public expenses. In 1990 they constituted a good 60 percent of GDP. The state's debt has risen to roughly 80 percent of the country's GDP. Almost half of this is owed to creditors abroad. The crisis is now deep and severe. For many people the Swedish model has become a warning rather than an ideal.

¹ The official figure is around 12% (Nov. 1997), but other methods of measurement give considerably higher levels; e.g., Ståhl and Wickman have calculated that only about 80% of those who would be employed in an ideal labor market are, in fact, employed. Their unemployment figure is thus about 20%. See I. Ståhl and K. Wickman, *En miljon utan jobb: Suedoscclerosis III* (in Swedish) (Stockholm: Timbro, 1995).

It is hardly surprising that some scholars found this pattern remarkable. First, Sweden's achievements during the period of advance could certainly not have been taken for granted. From a conventional economic point of view, one would rather have predicted that Sweden's extremely large welfare state, with its unusually high taxes and exceptionally generous social insurance, by severely disturbing incentives would badly hamper economic performance. But that did not happen. Economic growth and the welfare state seemed quite compatible, and it was therefore important to ask exactly how and why? What was the Swedish secret? Then, when such questions seemed to have been answered, Sweden's economic performance gradually began to worsen. This, of course, was also bound to astonish. How could a country that once performed so remarkably well, now be worse off than most other comparable countries?

One scholar who has discussed these problems is Mancur Olson, and he has done so in two works in particular. The one is the booklet *'How Bright are the Northern Lights? Some Questions about Sweden,'*² which deals mainly with the long, successful pre-crisis period. The other work, the article "The Devolution of the Nordic and Teutonic Economies,"³ deals with the crisis after the happy years.

2 Olson on Sweden's Success

Olson starts his discussion about the successful period by putting two nicely related questions:⁴

1. Why isn't the Swedish economy performing better than it is?
2. Why isn't the Swedish economy performing worse than it is?

Olson's answer to the first question relies on mainstream economics and draws attention to the compressed wage differentials, the high level of transfers, and the high taxation in Sweden. This answer, I think, is obviously correct and there is not much to discuss about it. The really interesting question is the second one: how is it that Sweden, in spite of its seemingly big obstacles to growth, performed so remarkably well, and in fact better than most other nations?

² The book is based on the Crafoord Memorial Lecture given by Mancur Olson at the University of Lund, Sweden, in 1986: Mancur Olson, *How Bright are the Northern Lights? Some Questions about Sweden* (Lund University Press, 1990).

³ Mancur Olson, "The Devolution of the Nordic and Teutonic Economies," *American Economic Review, Papers and Proceedings*, May (1995).

⁴ Olson, *Northern Lights*.

But even if the second question is the crucial one, I think that Olson's interpretation of the question is worth a comment. The obstacles that Olson has in mind are the large public sector and the fully developed welfare state. In essence, therefore, he asks why Sweden's extreme welfare politics did not hamper economic growth more than it did. This question is certainly worth asking, but it is nonetheless remarkable. Keeping Olson's own well known theory of national development in mind, a slightly different interpretation of the question would be more natural.⁵

What I am thinking about is Olson's contention that stable societies become increasingly sclerotic with age. The basis for this is two propositions that are derived from Olson's logic of collective action and are presented, among other places, in *The Rise and Decline of Nations*.⁶ The first one says that "[s]table societies with unchanged boundaries tend to accumulate more collusions and organizations for collective action over time," and the second one that "[o]n balance, special interest organizations and collusions reduce efficiency and aggregate income in the societies in which they operate and make political life more divisive." According to this, therefore, one would expect Sweden to be quite sclerotic since it is old and stable; and it would be natural to think about the second question as about why Sweden, being such an old and stable society, was not performing worse than it was.

Now, my reason for thinking that Olson's interpretation of the question should be avoided is that, in a sense, it takes the emergence of the Swedish welfare state for granted. The welfare state is brought into the discussion as a reason for putting a question, for which Olson's theory already has an excellent reason, and therefore the existence of the welfare state does not appear as something that needs an explanation of its own—which, indeed, I think it does.

After this we can now turn to Olson's answer to his second question. First, and contrary to many persons' beliefs, he says that a large public sector does not necessarily impede economic growth very much. He presents statistics supporting his assertion and also provides an explanation. Advanced welfare politics, as we know, is always associated with substantial redistributions, but such redistributions can be of different kinds.

Olson makes a distinction between explicit and implicit redistributions. An *explicit redistribution* is a cash transfer from taxpayers to particular beneficiaries, which are commonly deemed to deserve or need the money. An *implicit redistribution*, on the other hand, usually refers to the favoring of some selected people or firms by a new law of some kind; examples are tariffs or quotas favoring some particular industry. By their advocates, such laws are often said to be good for the society at large, and their redistributive character is

⁵ Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale University Press, 1982).

⁶ *Ibid.* p. 74.

thus concealed. An explicit redistribution will increase the public sector; an implicit one usually does not. Olson also argues that implicit redistributions, for several reasons, may disturb people's incentives much more than explicit ones, and thus may be more harmful to economic growth. "Inconspicuous redistributions," he writes, "are often also more costly to society than conspicuous ones: the costs that are not noticed are less likely to be minimized."⁷ The deadweight losses resulting from an implicit redistribution may easily become many times bigger than the favors enjoyed by the beneficiaries.

Now, Olson submits that the Swedish welfare state to a large extent uses explicit rather than implicit redistributions, and that is the first part of his explanation of Sweden's surprisingly good performance. In a second part he goes on to draw attention to the importance, especially for a small country, of the policies for international trade. He asserts, again perhaps contrary to many persons' beliefs, that free trade is very important for economic growth; and again he presents statistics showing that protective measures, such as quotas and tariffs, almost universally impede growth drastically. This, of course, exemplifies the harmful effects of implicit redistributions; the basic mechanism is that the protected firms, when not exposed to competition from countless foreign firms, can easily form cartels which will harm the national economy at large. Sweden, however, has never had a significant protective wall for manufactured goods, and that is the second part of Olson's explanation of Sweden's good performance.

Olson's explanation seems plausible but also leads to new questions about the causes behind the explicit redistributions and the non-existent protective wall. In his answers to these secondary questions, Olson emphasizes that Sweden's lobbying organizations, to a large extent, have been quite encompassing, and thereby inclined to abstain from destructive policies. An encompassing organization, in Olson's terminology, is an organization whose members represent a large share of the country's income-earning capacity. Since such organizations and their members to a large extent are affected by their own activities, they have strong incentives to be, from a general point of view, prudent. In Olson's words, "Encompassing organizations have some incentive to make the society in which they operate more prosperous, and an incentive to redistribute income to their members with as little excess burden as possible, and to cease such redistribution unless the amount redistributed is substantial in relation to the social cost of the redistribution."⁸ The opposite to encompassing organizations is narrow organizations, which, from a general point of view, are likely to behave irresponsibly.

The power in Olson's explanation of Sweden's surprisingly good performance thus comes from his assertion that Sweden's lobbying organizations to

⁷ Olson, *Northern Lights*, p. 60.

⁸ Olson, *Rise and Decline*, p. 74.

such a large extent are encompassing rather than narrow. True, he also discusses some ad hoc factors, exogenous to his own theory, such as the quality of Swedish economists and some historical experiences of the Swedish exporting industries; but these elements are marginal and may be disregarded here. The obvious next question therefore is: how is it that the Swedish organizations are so encompassing?

This question Olson answers only tentatively. In some places he indicates that Sweden's smallness and homogeneity may be an explanation, and certainly there may be some truth in this.⁹ First, smallness and homogeneity often go together. When, for example, a large piece of something, say a big rock, is divided into parts, those parts, individually, are likely to be more homogeneous than the original piece. Second, both smallness and homogeneity may favor encompassing organizations. If, for example, the costs for creating an organization depend only on the organization's absolute size, and not at all on its size in relation to the society at large, then, automatically, organizations will become more encompassing the smaller the country is. Also, it is reasonable to assume that the costs of an organization are higher the more heterogeneous a country is, which makes encompassing organizations in homogeneous countries more likely than in other countries. Thus, it is not unreasonable to think about smallness and homogeneity as causes of encompassedness. But neither is it, I think, very convincing; the arguments are too vague.

We may thus conclude that Olson's answer to his second question, about the surprising success of Sweden, in terms of encompassing organizations is basically sound, even if the mechanisms behind the encompassing organizations, and the emergence of the welfare state, remain obscure. Furthermore, Olson devotes hardly any space to the mechanisms by which lobbying organizations influence government. This is important, since the prudence or non-prudence of the organizations would not matter if they had no influence.

3 Olson on Sweden's Crisis

We may now turn to Olson's account of the Swedish crisis in later years.¹⁰ The basic question, of course, is why Sweden, which earlier performed so well, has become so overwhelmed by troubles. Olson's answers are short and tentative and, it should be said, do not claim to be anything else.

He suggests for example that the prior successful development may have

⁹ See e.g. Olson, "Devolution," p. 24.

¹⁰ Ibid.

led to overconfidence in the Swedish model, and thereby to "overshooting."¹¹ "The country," he writes, "came to believe that it could redistribute even more without excessive social costs." This argument is of course sensible, but also very vague; furthermore, it is unrelated to Olson's basic ideas about organizations, and in that sense is ad hoc.

This last criticism does not apply to another line in Olson's reasoning, in which he argues that the organizations that were earlier quite encompassing may have become less so, and therefore, according to his theory, also less responsible. In this argument Sweden's economic performance is considered as a reflection of the degree of encompassedness of its organizations. Olson here applies an idea that he has presented in several publications,¹² namely that encompassing organizations are inherently unstable and are likely to disintegrate into a number of narrow organizations. This disintegration, according to Olson, is caused by the same mechanisms as the emergence of narrow organizations within a society without any organizations. Basically, a minority within a large encompassing organization will find itself in the same situation as a minority in a society without lobbying or cartelistic organizations. These minorities will find the encompassing organization and the state, respectively, quite similar. Neither of them articulates the particular interests of the minorities, and these will therefore try to organize. In the one case it is the society without organizations that is changed, and in the other the society with encompassing organizations. In both cases the end result is a society with a lot of narrow organizations.

This idea about the encompassing organizations' instability raises some questions. How, for example, if they are inherently unstable, could encompassing organizations ever come into existence? To put the question somewhat differently, is there an equilibrium level of encompassedness or narrowness? If so, at which particular level is an organization narrow enough not to be threatened by further disintegration? What, in fact, hinders equilibrium to occur when every "organization" has one member only, or in other words when there are no organizations at all? And, if so, how is it that organizations ever appear? These questions, obviously, are only new variations of the basic question already put, concerning the determinants of an organization's degree of encompassedness or narrowness.

The idea about disintegrating encompassing organizations, even if generally true, is also, I think, of limited relevance for Sweden. First, the moderate disintegration that has occurred has consisted of deviations from the traditional centralized wage bargaining and is thus a labor market phenomenon not necessarily related to lobbying. Second, since a plausible main effect of the

¹¹ Olson, "Devolution," p. 24.

¹² E.g. Mancur Olson, "An Appreciation of the Tests and Criticisms," *Scandinavian Political Studies*, March (1986); Olson, *Northern Lights*; Olson, "Devolution."

decentralization is wider wage differentials, it is not clear that the results are harmful.¹³ Third, since the first deviations from centralization occurred about ten years after the first signs of the economic crisis, in the beginning of the 1970s, the causal order, if any, should not be from disintegration to crisis, but from crisis to disintegration—when the trough is empty, the horses bite. This, again, brings us back to the question about the basic mechanisms determining the extent to which an organization is encompassing.

Olson's dealing with the crisis period is, in my opinion, less convincing than his handling of the period of success. Some of his ideas are vague and unrelated to his own mainstream thinking. Another idea—that of disintegrating encompassing organizations—certainly belongs to his own theoretical framework, but fails to convince anyway. Olson is thus not only unsuccessful in bringing the two phases of the Swedish development under a common theoretical hat, but he also falls short of giving a plausible explanation for the crisis *per se*.

4 The Constitutional Factor

Some of the questions left unanswered by Olson require, I believe, some constitutional facts to be taken into account. Sweden has a parliamentary constitution with proportional representation. This determines the character of the political parties and therefore, as we shall see, is also relevant for the problems discussed here.

Parliamentarism is a method for appointing the executive, according to which the people first elect the legislature, which in turn appoints the executive. The legislature and the executive are thus, in a sense, appointed in the same popular elections. In a pure parliamentary system, the executive can furthermore remain in office only as long as it enjoys the confidence of a majority in the legislature, and this requirement is therefore often referred to as the *parliamentary principle*. The other main system is the presidential one, which uses separate popular elections for appointing a president and thereby also the rest of the executive.

A parliamentary system depends, for its functioning, on the existence of stable, centralized, and disciplined political parties in a way that a presidential system does not. The reason is that the parliament's confidence in the

¹³ P. A. Edin and R. Topel, *Wage Policy and Restructuring: The Swedish Labor Market since 1960*, in R. Freeman, B. Swedenborg, and R. Topel, eds., *Reforming the Welfare State: The Swedish Model in Transition* (Chicago: National Bureau of Economic Research/Chicago University Press, 1997).

executive, in order to be reliable and lasting, cannot be ad hoc, accidental, or anonymous. The confidence expressed by a transient majority of individual members of the legislature cannot, it is easy to realize, have much value. The confidence has to be expressed by one or a few stable and identifiable actors, which, in effect, means consolidated political parties. A parliamentary system however is not dependent only on such parties; conversely, I submit, it also gives strong *incentives* for the formation of that kind of parties; and sometimes also for forming big parties.¹⁴ The reason is that centralized leadership, stability, and discipline enhance a negotiating party's credibility and reliability and thereby its chances of becoming a member of the executive, a membership that often is quite attractive, or even lucrative.¹⁵

The proportional electoral system with multi-member constituencies can be compared with a plurality system with single-member constituencies (first past the post). The choice here affects the parties in two ways. First, the plurality system has a strong tendency to reduce the number of parties, in the extreme to two parties, whereas there are no such reductive forces operating in the proportional system.¹⁶ Second, in contrast to the plurality system, the proportional system puts strong *means* for enhancing discipline, and thus for the creation of stable and cohesive parties, in the hands of the party leaderships. The main factor here is that the candidates for the legislature are largely dependent on the party leadership, both for nomination and for campaigning.

Now, I submit, these mechanisms can be used for explaining the character of the Swedish party system. There are seven parties, which on the whole are disciplined, stable, and cohesive. There are no strong forces reducing the number of parties. The Social Democratic party is quite big. The incentives to discipline come from the parliamentarism, and the means from the proportionality. As a contrast, we may think about the United States with presidentialism and plurality. There, as we should expect, we find two main parties with low discipline.

These matters affect the distribution of power. In the Swedish system the

¹⁴ A big party often has the advantage of being the component from which a coalition-building process starts. Even small parties, however, may have advantages by fitting well into minimum winning coalitions in Riker's sense. See W. H. Riker, *The Theory of Political Coalitions* (New Haven: Yale University Press, 1962). The incentives related to size are thus quite complicated.

¹⁵ The idea that parliamentarism is dependent on stable, cohesive parties is generally accepted in political science. The converse idea—that parliamentarism enhances those party properties—is to my knowledge not discussed in a systematic way at all; and when the topic occasionally arises for some reason the idea is sometimes supported, sometimes discarded. An example of the latter is given by Sartori when he writes that “— party solidification and discipline [in parliamentary voting] has never been a feedback of parliamentary government”: G. Sartori, *Comparative Constitutional Engineering: An Inquiry into Structures, Incentives and Outcomes* (London: Macmillan, 1994), p. 95.

¹⁶ Maurice Duverger claimed that the tendency of a plurality system to enhance a two party system came close to being “a true sociological law.” M. Duverger, *Political Parties: Their Organization and Activity in the Modern State* (New York: John Wiley, 1964), p. 217. This relationship, often referred to as “Duverger's law,” is not however generally accepted in political science.

consolidated and disciplined parties can, as an approximation, be considered as unitary actors. The power is concentrated to the hierarchical summits of the parties. This does not mean, of course, that individuals are not important. It does however mean that the individuals almost exclusively play their roles within the parties. The individuals have a say in determining the party positions, and more so the higher up they are in the party hierarchy. When it comes to dealings with actors outside the party, for example with other parties, or with the electorate in campaigns, or with lobbying organizations, it is however usually the party as such, or the party leadership, that acts. Furthermore, during the current election period, the governmental power is held by the very few parties belonging to the executive or to the parliamentary majority supporting the executive. The US pattern is quite different. There, the party restrictions on the behavior of the president, and on the members of the Congress, are very weak indeed. All these individuals—several hundred—can therefore be considered as fairly independent actors. The power is spread out not only between the president and the Congress, but also among all the members of the Congress.

These different patterns should be of great importance. It thus seems likely that the *transaction costs* of political processes depend critically on the number of independent actors taking part.¹⁷ The number of independent actors is likely to affect the possibilities of building decisive majorities or blocking minorities, the character of the lobbying processes, and the expediency of various strategies in the political competition.

One particular aspect likely to be affected by the patterns described is the relation between voters (the principals) and the political main actors (the agents), whether these are parties or individuals. Two types of such relation are particularly interesting: the one may be called delegation, the other instruction.

Delegation is, in a way, the simpler of the two and many people are familiar with it from experiences in ordinary clubs and the like. When people in such associations elect presidents, secretaries, and so on, they usually do not require more than that they have confidence in the persons elected. They just want to be able to rely on them to act in accordance with common sense in the interests of the club. Feeling such confidence, they are happy to delegate the decision-making to the people elected. For the most part such a system works well, but if, for some reason, a delegate starts to act in ways of which the members disapprove, there are usually provisions in the club's charter for displacing the

¹⁷ The transaction cost concept was, as we know, introduced by Ronald H. Coase in economics, and by James M. Buchanan and Gordon Tullock in constitutional analysis. See J. M. Buchanan and G. Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Theory* (Ann Arbor: University of Michigan Press, 1962); R. H. Coase, "The Nature of the Firm," *Economica*, 4 (1937). In economics low transaction costs are generally considered desirable, but in politics, where the majority rule usually reigns, it is not necessarily so. Low transaction costs may, for example, facilitate the formation of majorities exploiting the outsiders.

functionary. This rather simple kind of relation occurs not only in clubs, but also in politics.

Instruction, on the other hand, prevails when the voters do not limit themselves to picking representatives in which they have confidence, but also require that they shall execute a certain program, which may be worked out in a rather detailed way. Therefore, at the same time as people are elected, a program that those elected are obliged to implement is, in fact, adopted. The program may very well be, and often is, formulated by the candidates who want to get elected. Different candidates for political positions thus offer to carry through different programs if they are elected. This, however, is fully consistent with the view that, once a candidate is elected, the program can be considered as an instruction *from the voters to the elected*.

It is easy to see that in reality, *mixtures* of delegation and instruction often occur. This, however, does not preclude the fact that sometimes the element of delegation dominates and sometimes the element of instruction. My hypothesis is that the Swedish system has a tendency towards instruction, whereas the US system has a tendency towards delegation.

The reason is simple. In a parliamentary system a campaigner, which in that case is a party, will be able to fulfill its promises if its electoral success is big enough. If, for example, a party alone gets more than 50 percent of the seats in the legislature, it can, by itself, form an executive and implement all its promises immediately. A presidential system is, in this respect, different. Imagine a person running for the presidency, or for a seat in the Congress. In both cases everybody knows that the person, after the election, and however great the electoral success, will not, without further cumbersome and yet uncertain negotiations, be in a position to deliver on his or her campaign proposals. Exactly for that reason, it would not be particularly clever, and perhaps even a bit ridiculous, to let detailed proposals, or instructions, dominate the campaign. It seems more expedient for the candidate to emphasize his or her own personal qualities, thereby indicating a capacity for prudent action in various future situations which, at the moment of the election, are impossible to foresee. That, on the whole, is what such candidates seem to do, and their resulting relation to the voters, therefore, is primarily one of delegation.

5 Lobbying

Olson's lack of detailed ideas about how lobbying organizations influence government is, as I see it, a salient deficiency in his argument. In order to

highlight this lacuna, we can consider a society with no lobbying organizations at all. From one point of view, such a society may be thought of as an extremely flexible and effective market economy, suffering from no sclerosis whatsoever. It is, however, also possible to think about all the individuals in the society as an equal number of organizations, which, then, are as narrow, and thereby as irresponsible, as they could possibly be. From this point of view, the society would be sclerotic in the extreme. This latter position is, of course, absurd, for the very simple reason that the individuals, considered as organizations, could not hope to influence the politicians. In spite of this, there is hardly anything in Olson's works that excludes this last position, since they do not contain, or refer to, any theory of influence. If, however, we take the constitutional setting into account, the outlines of such a theory become visible. I am thinking about two points in particular.

First, the obvious targets for the lobbyists are the centers of political power, which, in a parliamentary system, means the party leaderships. The lobbying will thus be concentrated at the summits of the political hierarchies. In a presidential system, on the contrary, the lobbyists will approach individual members of the legislature, or perhaps small occasional groups of such members. Thus, in a parliamentary system the lobbyists' counterparts are few and powerful, whereas in a presidential system they are numerous and, individually, much less powerful.

Second, the lobbyists are likely to ask for what they can get. In the parliamentary setting, with its inclination towards instruction, the lobbyists are therefore, to a large extent, likely to ask for various new reforms. Such demands are, without any value attached to the words, constructive or creative. In the presidential situation, with its tendency towards delegation, the demands will have a different tendency. Since the mechanism of instruction works badly, the lobbyists are more likely to play a negative, or a blocking, role. They will probably find it difficult to induce the politicians to bring in specified new reforms, but will find it easy to tell the politicians what not to do, and the politicians are likely to find that information valuable.

These ideas may be related to the widespread opinion that lobbying is a characteristic trait of the political life in the United States, and that lobbying there is more developed, and more influential, than in other democracies. This, I think, is wrong. Rather, I think that lobbying in the United States, where the targets are so many and so dispersed, cannot be restricted to a few closed rooms as in a parliamentary system, but unavoidably becomes open and visible to everybody. It is also, for the same reasons, less effective, and requires more resources, than lobbying in parliamentary countries. This view is compatible not only with the well known, and well published, lobbying activities on Capitol Hill, but also with the relatively slow development of the public expenditures in the USA, and the country's good long-term economic growth.

6 The Emergence of Encompassing Organizations

We can now return to the mechanisms behind the encompassing Swedish lobbying organizations, and the rise of the welfare state. In doing so I will at first emphasize that these things, obviously, cannot be given an exclusively constitutional explanation: other factors, such as people's ideas, certainly matter as well. But even if the constitution is not a sufficient condition for the encompassing organizations, and for the welfare state, it may nonetheless be a necessary one. I find it difficult to imagine Swedish society in another constitutional setting.

As for the issue of encompassedness, it may first be noted that some of the Swedish organizations are closely linked with political parties. In particular, the blue-collar workers' national confederation of trade unions, Swedish Landsorganisationen or just "LO," is closely related to the Social Democratic Party, not only ideologically, but also in a technical and organizational sense. In fact, it is common to talk about the unions and the party as the two branches of the labor movement. Similar, though not equally close, relations exist between the farmers' national organization and the Center Party, which is strong in the countryside. These close relationships presuppose that both parties are reasonably consolidated, and that they have lasting and clear identities. It is difficult to imagine similar relations between a consolidated organization such as the Swedish LO and loose conglomerates such as the Democratic and Republican Parties in the United States. Thus, there is a constitutional background here.

The unions engage in two important activities: bargaining for wages and other conditions of employment, and lobbying the governmental power (which often means the Social Democratic Party) on a wide range of societal issues, including legislation for the labor market. It seems likely that the unions, in their roles as bargainers, have a wish to control the labor markets and the supply of labor, and that these goals are more easily satisfied the more encompassing, and the more centralized, the union movement is. Consequently the unions are also likely to lobby for laws facilitating the fulfillment of these ambitions.¹⁸ The Social Democratic Party, in turn, is likely to welcome encompassing unions able to provide campaign funds and mobilize voters. In Sweden, with its prevailing political ideas and its constitution tuned for "instruction," the emergence of encompassing organizations should therefore

¹⁸ One example of an implemented legal rule of this kind is the explicit exclusion of the labor market from the area of application of the general law safeguarding market competition. Another example is the law about collective bargaining, including the very liberal rules regulating the organizations' use of blockade, boycott, and similar measures for enforcing outsiders into the framework of collective bargaining.

not come as a surprise. This tendency toward encompassedness, however, is also likely to have been stimulated by the Labor Movement's socialism. Certainly a socialist movement, with its inclination toward centralism and planning, will build encompassing organizations rather than narrow ones when able to do so.

7 The Rise of the Welfare State

These intimate relationships between the unions and the Social Democratic Party have furthermore been a fertile ground for the Swedish welfare state. The resulting consolidated, long-lasting organizational structures are able to develop and to harbor successively more and more elaborated, detailed, and comprehensive ideas about the construction of the society, and to implement them. Certainly, as Olson holds, these ideas are prudent in the sense that they are about the well-being of the society as a whole, and the contrast with careless policies of narrow organizations is thus sharp. Still, the prudence has a leftist touch.

Sweden has long had a large number of successful and technically innovative private enterprises. A deeply rooted commercial and entrepreneurial mentality is an obvious feature in the nation's culture. The tendency towards nationalization of the means of production has mostly been weak. Rather, production has mainly been considered the role of the private enterprises, while the creation of a comprehensive social security system has been considered an important public task.¹⁹ The social security system is here taken in a wide sense to include, for instance, the laws regulating the labor market. Those laws are, in fact, constructed in such a way that the labor organizations, within wide limits, are virtually able to determine the wage level. Thus, it is hardly the employers and their organizations, which are quite weak, that restrain the wages, but rather the threat of unemployment.²⁰ That threat, however, is considerably alleviated by the generous, almost completely publicly financed, transfers for the unemployed.²¹ Turning from the labor market to the general social security

¹⁹ The social security system, it may be added, has been valued by its supporters not only because it alleviates human problems, but also because it functions as a built-in stabilizer over the business cycle. See E. Lundberg, "The Rise and Fall of the Swedish Model," *Journal of Economic Literature*, March (1985), p. 14.

²⁰ This weakness is, to a large extent, a consequence of the nature of the weapons of strike and lockout. Laws of the kind mentioned in n. 18 above are also important in this context.

²¹ Apart from being welcomed by the unemployed, these generous public transfers are also important for the organizations themselves. Without such transfers, unemployed (and therefore unsatisfied and disloyal) members could easily threaten an organization with disintegration. These generous transfers thus illustrate how the political power helps organizations in their ambition to become, and remain, encompassing. This point is made by I. Ståhl and K. Wickman in *Suedosclerosis II* (in Swedish) (Stockholm: Timbro, 1994) pp. 27 f.

system, it is enough for our purposes to state its far-reaching, and generally generous, character. In spite of the extensive use of explicit rather than implicit redistributions, this entails two important risks.

First, people may engage in rent-seeking behavior, which means that they will try to become members of groups entitled to transfers of various kinds. Second, the state may become committed to very large, and almost unpredictable, future expenses. If, for example, for some reason the number of unemployed suddenly expands rapidly, unemployment transfers will increase drastically.

8 From Success to Crisis

Sweden's smallness, and its direct contacts with foreign markets, are important for understanding its predicament. Mancur Olson has emphasized that a liberal trade policy is of crucial importance for the effectiveness of the economy, but that is not the only aspect. A small and open country must also be extremely flexible and able to adapt rapidly to all kinds of price changes in the international environment. With increasing advantages of scale and specialization, and thereby increasing dependence on foreign trade, this need for flexibility is continuously growing. Important parts of the Swedish society, and in particular the labor markets, have however become increasingly *less* flexible, which has increased the vulnerability to price shocks. The crude price hikes in the 1970s and, more important, the sharply increased real interest rates in the beginning of the 1990s, were therefore ill-fated.²²

This should go a long way toward explaining the crisis. When a price shock hits an inflexible country such as Sweden, the needed adaptation comes only very slowly. In the meantime, the formidable social security system starts working. Most important, wages do not adapt when necessary but instead stiffly escalate their yearly percentages, as required by tradition, "justice," and the public philosophy. Unemployment therefore increases drastically, and so do the public expenses; and the crisis is upon us.

²² A detailed account of "the real interest shock" is given in Ståhl and Wickman, *Suedosclerosis II*.