Can China Learn from Sweden?

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1. Introduction

One might think that Sweden and China have very little in common. While the Swedish economy in many ways epitomises the technological advances and high living standards achieved by countries of the "north" since the Second World War, China is still by comparison a poor, albeit fast-growing, country. Yet, it is only about a century ago that Sweden was a relatively poor agrarian outpost at the European periphery. Poverty was extensive, leading to mass migration, and compared with the rest of Europe the industrial revolution arrived late. Apart from the cold and unfriendly climate, the country was situated at a remove from the main world trade routes.

In spite of these poor initial conditions, Sweden today can be characterised as a fully-fledged welfare state that has eliminated poverty and created technological niches that has placed it, in spite of its small population, at the frontier of international economic development. The country has evolved institutions that have led to peaceful co-existence, political pluralism, efficient mechanisms for conflict resolution and consensus building, social compassion—as depicted by systems for the care of the old, sick and handicapped—as well as flexible economic policies.

China has undergone dramatic changes since the Communist party took power in 1949. Initially the country followed a relatively traditional socialist planning strategy, but in 1978 it entered on a path of market reform and increasingly liberal economic policies. The growth effects of these reforms have been spectacular, and although poverty is still widespread, the incidence of extreme poverty has declined very significantly. One might

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wonder whether fast-growing China can learn anything at all from Sweden. This is the question we explore in this paper.

Much like Sweden when it embarked upon its development path around 1870, China today remains well behind the global technological frontier. In terms of growth strategy, this means that it will have to rely, at least initially, on catching-up growth rather than frontier growth. In other words, China at present mainly has to borrow and apply technologies existing in the industrialised North rather than developing its own genuinely new technologies. For the catch-up process to work, however, China needs to have an effective institutional structure in place. A key question is whether China has a structure capable of sustaining its full transformation to a modern market economy. If its institutions can support innovation and productivity improvements, that would enable sustainable long-term growth. On the other hand, if the institutional structure is not benevolent in this regard, the positive growth effects from innovation and investment activity will be hindered.

The paper is structured as follows: In Section 2 we will describe the emergence of the Swedish Model, while Section 3 summarises the main strands of the model and the various institutions, both economic and political, that have sustained it. Section 4 discusses the sustainability of Sweden's welfare state. In Section 5 we ask what lessons China can derive from the Swedish experience with respect to the market system (5.1), the role of the state (5.2), governance and the rule of law (5.3), the welfare state (5.4), and support for private sector development (5.5). Finally, in the concluding section (6) the study discusses the relevance of the Swedish model for China, noting especially the constraints to its replication.

2. Emergence of the Swedish Model

The development of Sweden in the last century and a half demonstrates that economic backwardness and poverty need not be immutable. Around 1870, Sweden was relatively backward compared with countries in the rest of Western Europe. Since then, however, its position—like that of the other Nordic counties—has improved dramatically (Södersten, 1991; Schön, 2000a, b; Eklund, 2000).

During the period 1870 to 1970, Sweden was the fastest growing country in the world alongside Japan, with an average per capita income growth

of 2.4% per year. This growth rate was higher than that of the rest of Europe (1.7%) and the USA (1.8%). To some extent this rapid growth was a catch-up effect, and by 1970 the gap between Sweden and the rest of the industrialised world had been closed. Sweden had abundant natural resources, which had been in the background as long as agriculture was the centre of global development. When industrialisation got underway, these resources became the basis for increased export revenues.

The fact that Sweden was able to catch up was, however, not mainly due to the abundance of its natural resources. More important was that the country had developed a good educational base among its general population, which laid the foundation for technological innovation. In the late 19th century, there were several Swedish technological breakthroughs, which enabled Swedish firms to gain dominating positions in the world market in several areas. The Swedish system was also able to maintain an environment conducive to industrial innovation and development. This period of rapid growth in Sweden came to an end around 1970, when the country ran into problems. The growth rate over the next 25 years shrank to 1.2%, while the rest of Europe saw per capita incomes grow at 1.8%, the USA at 1.6%, and Japan at 3.0%.

To sustain rapid growth over such an extended period, the economy needs both to be able to bring about structural change at the same time as it increases the productivity or efficiency of existing activities. In terms of structural change, Sweden has gone from a labour share in agriculture of about 80% in the mid-19th century to 1% now. Much of the growth during this period was thus due to the transfer of labour out of less productive activities into more productive ones, but efficiency-improving investments and innovations were probably even more important for long-term growth.

We started by arguing that infrastructure and institutions are vital for growth. Laws and regulations may facilitate investment, the supply and application of relevant knowledge, as well as the efficient functioning of markets. When new technologies emerge, production structures need to change, infrastructures need to be rebuilt, and new skills need to be supplied. Sweden has been effective in creating institutions that have supported such changes and thereby growth.

3. Main strands of the Swedish Model

One feature that for a long while characterised the model was *an activist stabilisation policy*. This started in earnest in 1932, when the new Social Democratic government in Sweden initiated expansionary economic policies, largely in the form of public works, to combat mass unemployment. Full employment was a central aim of the Swedish strategy, and during the first decade of the postwar era unemployment lay in the range 2–3 per cent. The desire to fine-tune the business cycle is much less evident now. There has been a shift towards more stable policy rules, and among the Social Democrats, there is a strongly felt need to have a robust budget stance that ensures the government has some scope for action and intervention when there is a risk of increasing unemployment. One significant dimension of the macroeconomic strategy was the investment fund system, whereby firms could deposit profits without taxation in the central bank in an interest-free account. They could then use this money, after government permission, when the business cycle was going down.

A major aim of economic policy was to keep interest rates low. This was achieved through extensive *controls of the credit market* in combination with a closed capital account and a fixed exchange rate. Real interest rates were actually negative part of the time.

In spite of generally socialist credentials, Swedish governments had a *liberal attitude towards business*. The Swedish model did not imply large-scale nationalisation, but there was high taxation of the profits distributed to business owners. As long as profits were reinvested in the business, however, they were only lightly taxed.

The *role of trade unions and employer–labour relations* are also important aspects of the model. Early on there were numerous strikes, but from the 1930s Sweden developed peaceful and harmonious employer–labour relations. The degree of unionisation was very high, and an increasing centralisation of wage negotiations made it possible to achieve peaceful and comprehensive wage settlements. The solidaristic wage policy was an important ingredient in the Rhen–Meidner model, and could be achieved since the trade union movement was centralised and increasingly powerful. There have been isolated attempts to pursue a state directed incomes policy, but market participants have been very much against this. Therefore wages have essentially been set in free negotiations between

employers and unions. Since the 1980s, however, wage settlements have become more decentralised, but there is still an informal co-ordination of settlements in various areas of the labour market.

The extent of *market interventions* has varied by sector. In the case of the labour market, the strategy was to make it work better by introducing measures to improve mobility, such as through labour exchanges, relocation subsidies, etc. In the case of financial and capital markets, however, interference was extensive. Banks were forced to buy government bonds or to finance housing investment. There was a guided investment policy.

Sweden, realising that as a small country it had a lot to lose from protectionism as distinct from free trade, has pursued a very *liberal trade policy*. Sweden has not had any extensive legislation on domestic competition, but has used free trade as a substitute (Hjalmarsson, 1991). Firms have been unable to exploit domestic monopoly positions since foreign goods have provided a price check. Since the mid-19th century, domestic trade has been deregulated in most areas, although there have been interventions (which continue) in the housing and agricultural markets.

The creation of a *welfare state* had two basic components. First, extensive provision of tax financed public services such as education and health. Second, the creation of a very comprehensive system of social insurance. The system had high ambitions of equality of consumption and income. Taxation levels were thus very high, as was redistribution. There were high and progressive income taxes, wealth taxes and large payroll taxes plus, from the 1960s, extensive indirect taxes. The system aimed to transfer money from the better off to the poorer segments of the population. At the same time, of course, the system was an insurance mechanism, transferring money over the life cycle of an individual with transfers received as a child and as a pensioner, while high taxes are paid into the system during the active working period in between. With the growth of the middle class relative to the working class, the system has gradually been adjusted to keep middle-class support, without which the existing comprehensive welfare system might well crumble.

The *social climate* was generally such that dynamic changes were accepted. This to some extent depended on the good employment prospects, and safety nets that were there in the form of the welfare state. During the glory days of the model, the system was controlled by the

Social Democrats in close collaboration with the trade unions. When the model ran into trouble, the Social Democratic hegemony was lost, and since then the liberal–conservative opposition has been in power several times. Still, the political consensus across the political blocks has been extensive, and one may note that in spite of right-wing parties in power, the basic ingredients of the welfare state are still there. There has been an increased openness to market solutions, but much of the reform in this direction has actually been undertaken by Social Democratic governments. It seems fair to say that all the political parties—except for the old communist party (now called the left party), and the green party—have converged to appeal to the 'average' voter.

4. The decline of the Swedish Model[1]

4.1 Did the Welfare State lower economic flexibility?

With the first oil shock in 1973/74, the Swedish model ran into problems. Sweden attempted to pursue a "bridging policy", while other industrialised countries did not, which meant that external and internal macroeconomic imbalances escalated. Sweden delayed the pain of adjustment, but growth in the longer term declined more in Sweden than in comparable countries. Per capita incomes over the next twenty years only grew at 1.2% per cent per year. Sweden also came to lag behind the other Nordic countries while, for example, Norway, which benefited from the discovery of oil in the North Sea, grew at 2.7%, and Denmark and Finland grew at about 2% per year. Thus the other Nordics caught up with and surpassed Sweden in terms of per capita incomes.

With slow growth and with attempts to maintain employment levels, Sweden again increased its foreign debt. In the light of this experience, the Swedish model came under renewed scrutiny. One concern now was that a structure that lacked flexibility had emerged, to replace the old model which supported structural change. The policies that had evolved hindered the markets from functioning effectively. It was felt that the need for functioning goods and labour markets was not appreciated enough. Lundberg (1985) argued that the Swedish model did not pay enough attention to its micro underpinning. High taxes, wage suppression,

[1] There is an extensive literature on this issue, but good general reviews are provided by Lundberg (1985), Bergström (1992), and Lindbeck (1993, 1997).

and extensive transfer systems reduced work incentives, while mobility in the labour market was low. The regulation of the credit market led to inflexibility in the allocation of credit, while domestically protected sectors, such as housing, tended to crowd out internationally competitive sectors.

During earlier structural crises, Sweden had been able to adjust quickly and the changes had been favourable from the view of the Swedish resource base. Now, however, there was a global shift towards more services provision and knowledge-based production—along with a need for flexible labour and capital markets. This contrasted with the Swedish base in heavy industrial investments; sectors now in crisis, like mines, paper, steel and shipyards, predominated in the Swedish economy. A major rationalisation and restructuring of industry started in the 1970s, and heavy industry was gradually reformed and reduced. Subsidies remained that slowed down this process, but in a small open economy the scope for special interests is limited.

The system also had socialised savings to some extent. Collective pension savings had replaced private savings. There was a concern for what this might imply for the control of the economy, particularly with regard to private enterprises. The most ambitious attempt to change the system was the wage earner funds that were briefly set up in the 1980s with the intention of investing part of firms' profits and wages in funds largely controlled by trade unions. This was a very controversial issue in Sweden and the system was essentially scrapped when the Social Democrats lost power in the early 1990s. Lundberg (1985) argues that the attempt to create this system was an example of the loss of the pragmatism that had previously characterised the Swedish model.

4.2 Dismantling the Model or reforming it?

During the 1980s, several elements of the Swedish model were dismantled (Jacobsson, 2000). The reforms started with a major devaluation in 1982. This meant that the public foreign debt increased, and this, together with dramatically increased real interest rates, contributed to the gradual reduction of the public sector. Public sector employment could no longer increase. The state was also forced to reduce investment in infrastructure, unlike during previous periods of dramatic structural change. Wage setting arrangements changed, and the credit market was liberalised.

Productivity growth was slow in the 1980s, although employment increased again after the large devaluation. Still, it seems fair to say that some of the structural changes that were started were important for the creation of a new environment for long-term growth. There was a boom in the second half of the 1980s, when Swedish wages grew much faster than the rest of Europe, while the country had a fixed exchange rate. This meant that by the early 1990s, firms were under severe pressure and eventually there were widespread bankruptcies. The deregulation of the credit market had also led to a rapid expansion of credit and there was a tremendous increase in prices of assets, ending in a collapse of asset values in the early 1990s and a banking crisis. In 1992, the Central Bank had to give up defending the currency and let it float. In 1990–91, there had also been a major tax reform, which meant that interest costs were no longer deductible to the same extent as before, and this meant that households essentially were exposed to a double interest rate shock.

The whole financial market was threatened, and there was a dramatic contraction in credit. Many firms collapsed and unemployment shot up to levels that had not been seen since the 1930s. This exerted an enormous pressure on the budget to maintain the commitments of the welfare state to pay unemployment benefits at the same time as tax revenue fell. When public expenditure peaked at 70 per cent of GDP, the tax system could no longer cope. The deficit shot up to 13% of GDP in 1993, and the open unemployment rate went up to around 10 per cent. It was, moreover, hard to maintain tax levels that were much higher than those of major competitors.

The structural changes in industry speeded up and new sectors started to emerge. Simpler jobs tended to disappear from the more traditional sectors. There was a shift towards a market-oriented service society. Services increased to above 70% of total employment and particularly the private sector expanded. During the second half of the 1990s, Sweden came to be in the forefront of the IT revolution, and this type of private sector activity increased in importance. Within industry, the more knowledge-intensive sectors such as pharmaceuticals, telecoms, etc. increased their share of employment. There was also increased merger activity, with large Swedish concerns merging with large foreign ones. Increased global integration meant large Swedish multinationals became less and less Swedish. Sweden also joined the EU in the mid-90s. A new inflation norm was

established in the 1990s, which has managed to keep inflation around 2%. Wage agreements have been moderate and industry profitability has increased. Due to greater competitiveness, the Swedish trade balance has been in surplus, reflecting the country's greatly improved financial situation. Growth in the later 1990s was rapid, and it has remained above the OECD average in the new century.

There were, of course, also external factors that made the Swedish model more vulnerable. With increasing external competition and global market integration, it became increasingly difficult to pursue policies that hamper the competitiveness of firms and fail to provide incentives for capital and labour that are comparable to those of other countries. The fact that an unusually large share of employment was in the public sector that was less productive than the private sector hampered overall productivity growth.

The reforms have liberalised the system, but there is still a (slightly less generous) welfare state, and social security is still strong. From a Rawlsian perspective, the Swedish system still has few competitors. The poor do well compared with most other countries. The social and political climate remains relatively harmonious, and labour–employer relations are good. The system has shown itself capable of reform and has been able to withstand dramatic structural change. It seems quite likely that major elements of the welfare state will be maintained for the foreseeable future. Welfare systems may come in other forms, but it seems unlikely that Sweden, despite its now more liberal leanings, will ever follow entirely the US model.

5. Relevance of the Swedish Model to the Chinese experience

5.1 The importance of economic flexibility and market integration

Among the lessons of the Swedish experience has been the importance of structural and policy flexibility for economic development. While the industrialisation drive in the region started in earnest in about 1870, already between 1840 and 1870 the Swedish government had undertaken major reforms of the economic system including the removal of domestic restrictions on trade, opening up for international trade, and reforms of company law and banking legislation.

During the first half of the 19th century, Swedish per capita incomes grew at half a per cent per year, while the population was growing by about one per cent per year. Growth during this period was based mainly on agriculture. New land was planted and land ownership was consolidated. The limits of ownership became better defined and farmers moved out of villages to live on their consolidated farms. The process of growth led to market expansion, which supported some growth of handicrafts and small-scale industry. Still, from a longer-term perspective the most important events during this period were probably the emergence of new growth-supporting institutions. The government invested heavily in the creation of a transport infrastructure in the form of a national rail network, largely financed by loans from the European capital market. There were, furthermore, institutional changes that made the markets more flexible, such as free trade, free capital movements and increased mobility of people. Sweden was part of the Western European cultural sphere and could easily benefit from economic integration. Trade increased and technology and immigrant entrepreneurs arrived from elsewhere in Western Europe.

Export activities, based as they were on raw materials and agricultural commodities, meant broad segments of the population could benefit from the expansion through a trickle-down effect. Since the production technology was simple, a lot of unskilled labour was employed initially. Resources that had previously been virtually worthless, such as marginal land and forest in the north of the country, now became valuable. There was to some extent a vent-for-surplus export expansion.

At the beginning of the industrialisation process, Sweden was rich in natural resources and labour, but poor in capital. Market integration led to large inflows of capital to Sweden (as is the case for China today). The capital importers were largely the state, counties, banks and other financial institutions, which then lent on to investors in industry and agriculture or invested in infrastructure and urban development.

With recourse to international capital and investment, wages increased, as did consumption. During the period 1850–1910, Sweden had a virtually permanent deficit in its current account. At the start of World War I, it was probably the most indebted country in the world in per capita terms. Sweden's external debt at the time is estimated to have been 75% of GDP. If loans had not been forthcoming, investments would have been lower and growth and structural change slower. One aspect of the increased

economic integration of the world was that more than a million Swedes (out of a total population of 5 million) emigrated to America during the half century preceding World War I. Thus with capital moving in and labour out, factor prices changed dramatically in Sweden. Between 1870 and 1910, wages increased more rapidly than elsewhere. Real wages increased faster than GDP (2.8% vs. 1.7%), which meant that sectors that depended on traditional comparative advantages of cheap labour and abundant natural resources came under pressure relative to those sectors that used more advanced techniques and capital. O'Rourke and Williamson (1999) show that much of the Swedish catch-up in terms of wages was due to labour emigration rather than trade and the standard Stolper–Samuelson effect. There is some migration out of China at present, but the world is less open to the immigration of (particularly unskilled) labour today. Still, by being able to attract high volumes of foreign capital, factor movements help to equalise factor prices. Wages in China are obviously increasing very rapidly at present, reducing the wage gap with Western countries.

A major problem in the Swedish Development thinking of the 1950s was how to combine low levels of unemployment with low inflation. The solution to this came to be known as the Rehn–Meidner model (Meidner and Rehn, 1951). It recognised that in a market economy there would be some regions or sectors that did well while others would lag behind. There would be problems of unemployment for the latter. A general expansionary policy was considered to be a bad option, since it would lead to inflation as some sectors were already at full capacity. There would be high profits in those sectors, wage drift, and cost–push inflation. To achieve effective resource use would then require the transfer of resources from the poor sectors to the booming ones. There was also the introduction of selective measures to create jobs in the regions with higher unemployment. It was also felt that if profits were highly taxed, there would be less pressure for inflationary wage settlements. With low wage increases, the inframarginal firms would make high profits, but due to the high rate of taxation if they were distributed to owners, these profits would stay locked in the firms concerned. The policy was also meant to be growth supporting, since it knocked out the low productivity firms, while the most productive could make large profits and thus be able to invest and expand.

The firms that grew during this period were largely created at the turn of the century and then consolidated in the 1920s and 1930s, although some major new ones such as TetraPak, IKEA and H&M have since emerged. It was mainly capital-intensive industries that grew during this period, while labour intensive sectors, such as textiles and clothing, the food industry and agriculture shrank. This structural change did not arouse too much opposition, since employees laid off tended to get new jobs relatively quickly, not least in the expanding public sector.

This process increased the pressure for structural change in Sweden. The transformation meant that industrial workers became a more important group, at the expense of those depending on agriculture. Some of the basic ingredients of the Swedish model emerged from the experience of structural changes occurring alongside or causing rapid increases in real incomes. Labour movement leaders and industrial owners shared a positive view of Swedish international dependence; they appreciated the need to rationalise industry to make it more competitive, and accepted structural change. As for Sweden, so with China today: access to international markets for goods and capital has been and obviously continues to be crucial for the development of China. The WTO accession is one step further along the way to international market integration.

5.2 Defining a credible role for the State

Sweden has had a higher degree of government intervention than other developed regions of the world, excepting perhaps Japan. However, governments were careful to ensure that this did not overly distort markets or lower incentives and thereby productivity. In the 1930s, a long period of political hegemony for the Social Democratic party was established. This party advocated a more active policy stance vis-à-vis the mass unemployment of the early 1930s. Keynesian stabilisation policies, as advocated by leading Swedish economists (the Stockholm School with Lindahl, Myrdal, Ohlin and others), had already been introduced in Sweden around 1930. It was widely felt that the government should improve the social security of the population in the new and more turbulent economic situation. The majority of the population was now dependent on wage income. The idea that income needed to be redistributed from the better off to the poorer segments of the population was established. The Social Democratic party

launched a new social contract labelled *folkhemmet* ("the people's home"). Nobody was to be left out of this new "home".

Sweden managed to get through the Great Depression of the 1930s better than many other countries. To some extent this was due to an expansionary Keynesian policy, but probably more so to the fact that Sweden left the gold standard in 1931 and then had a large devaluation of its currency. This ensured a good competitive position for Swedish exporters throughout the ensuing decade. That situation in some ways resembles the Chinese position today, with an undervalued exchange rate that provides China with a competitive advantage (unfairly so, say the competitors).

The 1950s and 1960s were decades of record growth in Sweden and elsewhere. The war-torn economies needed rebuilding and new industries grew. The role of the state increased as it invested in infrastructure and public services like health and education. There was some modest nationalisation of industry, but essentially Sweden has remained a private capitalist economy. The debate on such issues as the nationalisation of the banks was very heated in the late 1940s, but the opposition won the debate and since then it has been subdued (except for the period after 1968, when it briefly resurfaced). Internationally, the global financial system was formed at Bretton Woods and gradually economies started to reintegrate. International free trade areas like the EEC and EFTA emerged. So there was increasing internationalisation, at the same time as in Sweden government interventions increased. Sweden grew fast, but the countries that had suffered during the two world wars started to catch up.

The Swedish model that had emerged during the inter-war years meant the development of the welfare state and a more interventionist stance with regard to labour and capital markets. The aim was to achieve high and rapid growth while at the same time ensuring the benefits were reasonably evenly spread. The welfare state took over some of the obligations that previously had rested with the family, and this eventually paved the way for the broad entry of women into the labour market. Many women actually entered the public sector producing services in education, health, childcare and care for the elderly. The role of the public sector as a provider of services increased rapidly. At the same time, the public sector developed extensive transfer activities in the form of child allowances, pensions, unemployment benefits, sick benefits, etc. The transfers were

large in money terms, matching the greatly increased extent of government activity. Not surprisingly, the level of taxation was increased dramatically.

The aim of the interventions in production activities was to make it possible to exploit comparative advantages and thus grow fast, and to create resources for the welfare state. Sectors that were competitive were to grow, while those that were not were allowed to shrink. A strong pressure for structural change was created by the so-called solidaristic wage policy, which meant that wages should be equalised across sectors. Those that could not bear the cost would then be squeezed out, while those that were profitable actually were favoured by labour not demanding the maximum the firms could pay. At the same time, capital markets were controlled and investments were favoured. Firms' dividends were heavily taxed, but as long as funds were reinvested they were taxed lightly. This meant that existing profitable firms could grow fast, but capital mobility across activities was hampered. This later on would turn out to be a problem, when there was a need to shift profits from mature firms to newly emerging sectors. Labour-intensive industries declined, as did agriculture.

The 1960s was a period of record growth, but at the same time a structure emerged that was vulnerable. Investments were concentrated in heavy industry, which reinvested its profits in its own activities in the form of real capital. This was supported by the existing policy incentives. The Swedish model also meant that investment in house building and the public sector was favoured. These trends meant that Sweden eventually became locked into a structure that lacked flexibility.

5.3 Governance issues and the rule of law

What lessons are there for China in the area of governance? One feature of the development in Sweden that would be of interest for China is how institutions came to be formed that contributed to the creation of an increasingly egalitarian and wealthy society. This is obviously a huge topic that would deserve extensive historical analysis. Still, what can be said against the background of the mini-history sketched above?

Between 1890 and 1910, the modern institutions of Swedish industrial society emerged, such as the Social Democratic Party, The Federation of Employers, and the Central Trade Union Organisation. However, it was not until the period between the 1930s and the 1950s that economic

policies were reformed and the system that came to be known as the Swedish Model developed. The period 1950 to the early 1970s may be regarded as the golden age of the Swedish model, when growth was very rapid and the country finally moved to the top layer of nations in economic terms. In 1970, Sweden was ranked as number four in the world in terms of purchasing power per capita.

We may note that although Sweden was involved in extensive international wars until up to the days of Napoleon, since then (1815) Sweden has been at peace. The peaceful environment has been positive for economic development. China, on the other hand, is a super-power, which means that it is likely to spend huge resources on the military. It is unlikely that this is going to be beneficial for its economic development, although there may be some spin-offs from military industry. As long as there are no serious open conflicts, the negative consequences should be limited. There are no easily transferable lessons from Sweden as to how possible international conflicts involving China can be avoided.

Democratic institutions emerged gradually in Sweden over a very long time, until the country became fully democratic around 1920 when women got the vote. There have, of course, been political conflicts, but these have generally been solved in a consensual and pragmatic fashion. This way of solving conflicts of interest is the end result of a very long historical process, where it is hard to point out exactly which factors have been the most important.

One aspect of Swedish life is the extensive network of organisations that make for a strong civil society. Such organisations have a long history in the rural areas, but during the industrialisation phase there was a proliferation of very active political parties, trade unions, temperance organisations, independent churches, sports clubs, etc. Sweden might be a good example of a culture where trust has been built through extensive and peaceful interchange between individuals and groups in a range of organisations. To build trust in China, one would likewise need to allow the emergence of independent non-state organizations. This does not currently seem to be on the Chinese government's agenda.

The mode of political operation is also clearly reflected in the style of leadership. The Swedish style is one of consensus building, with some similarities to the Japanese approach to decision-making. The leader is expected to be a consensus-builder. There is also a tradition that

agreements are negotiated between the relevant parties, and before the government introduces new laws there are generally committees with the relevant parties invited that produce a report and this is then sent out to all interested parties inside and outside parliament for comments. These are then taken into account by the government before it presents its bill to the Parliament. This form of consensus-building seems to be quite different from what the Chinese government does.

Sweden has a decentralised administrative structure, where local councils take a lot of the decisions with regard to how to organise schools, health services, etc. This has meant that local citizens are very much involved in political decision-making, and there is a relatively small distance between voters and at least the local politicians. This probably has contributed to confidence building. Assuming that the local politicians are more able to gauge the desires and needs of the local community than central policy makers, it may also have made decision-making more efficient.

Swedish local authorities have extensive powers of taxation, and thus a good source of income. This ensures them a measure of independence from the central powers. Although in China there is considerable decentralisation, there is probably less scope for local leaders to pursue policies that are contrary to those of the ruling party. To allow a political opposition to emerge in China would give the government a higher degree of legitimacy. This could also increase participation and the efficiency of policy making. Still, in countries with large regional differences in income levels, there will always be a large need for a centralised system of transfers from the better off to those worse off, although decisions on spending could be taken locally.

One ingredient of the Swedish model has been the close links between the government, labour and industry. Some have referred to the system as a system of corporatism, where the lines of demarcation are blurred and it is unclear who is ultimately responsible. There needs to be checks and balances. Corruption and rent-seeking have not been major constraints on Swedish economic development. There are many anecdotes about Chinese corruption, but how extensive it is and whether it has had any significant effect on growth remains unclear.

5.4 The fundamentals of the Welfare State—social insurance, social inclusion and conflict management

What ingredients of the Swedish-style welfare state can be replicated in China? We may first note that the churches in Sweden had for a long time the responsibility for teaching the population to read and write, but from the 1840s primary education has been compulsory. This meant that essentially the whole population became literate, a major advantage. But it seems that China too has progressed far along the education route.

There has been a debate in Sweden as to whether the welfare state has hindered structural changes or whether it has facilitated them. The latter argument has been based on the notion that if you have basic security you are willing to accept change, since you know it will not leave you destitute. Rather, the system ensures that you manage reasonably well, while you transfer to a new firm or a new sector where you again will be earning approximately the same salary. Whether this effect outweighs the negative incentive effects is not at all obvious.

China cannot currently afford such a strong safety net, but a reasonable assumption is that some trust in the government and some confidence in the future would make it easier for labour to accept the dramatic structural changes that are ongoing in China. Political confidence building has to be made on the basis of the local political process, and there are certainly large differences between China and Sweden in this regard.

5.5 A conducive environment for developing private enterprise—property rights and regulatory institutions

By 1910, some Swedish manufacturing firms had become world leading. Firms like AGA, ASEA, LM Ericsson, Separator and SKF were all based on unique Swedish innovations. However, heavy industries such as pulp and paper were also important, with access to cheap electrical power helping them introduce new technologies. So Sweden at this time was not just applying foreign technology, but with its own innovations was actually helping to shift the technological frontier.

The Swedish government has generally been supportive of private enterprise. We have noted that property rights were clearly defined at an early stage, which helped pave the way for the private enterprise economy. The state has not been a major factor in primary or secondary production, although, as discussed, in recent decades it has had a large role in the

provision of health, education, and a range of other social services. The Chinese state still controls a sizeable part of the economy, and is also involved in various forms of ad hoc non-market interventions. The experiences of Chinese state firms suggest that the Chinese government should follow the example of Sweden and reduce its involvement in and interference with directly productive activities.

We also noted that goods markets were liberalised early on, although there has been continued intervention in housing and food markets. In Sweden the use of price controls to manage inflation has been used only in emergencies, and the experience of such attempts suggests this is not an efficient tool for either supporting growth or creating justice. Extensive price reforms have been undertaken in China since 1978, and the economic system has changed dramatically.

The Swedish judiciary is independent and during the whole period of industrialisation it was able to deal effectively and largely impartially with legal conflicts arising between enterprises. Effective bankruptcy legislation, for example, is a very important ingredient in a system that needs structural change, and where firms will invariably die and (sometimes) be resurrected. It seems to me as if China in such areas has a very long way to go, and one of the intricacies of Chinese economic development that is hard to understand is how investments can be so high and growth so fast in spite of unclear property rights. I suspect in the absence of change in this regard the lack of clearly defined property rights may become a severe constraint on Chinese development.

The Swedish government early on took responsibility for the creation of an effective transport infrastructure. To finance this it borrowed heavily abroad, not unlike many least-developed countries (LDCs) of late, but the growth response was good and events favoured Sweden, making it possible to repay the debt. In China there have been large improvements in the infrastructure over the last few decades, but in large parts of the economy it is very poorly developed. It is probably important to try to reduce these regional imbalances, if political stability is to be maintained.

In Sweden, the infrastructure was largely built and run by the government, with some exceptions. There has been some movement in the privatisation direction recently, though, and whether this may be an option for China as well is not clear to me. The aggregate investment rate in China is so high that it is hard to imagine that it can be increased much

further even if private capital is used more extensively for infrastructure investments.

A major concern in the infrastructure area for poor economies is that it has often been hard to develop effective systems of maintenance, which means that a lot of investments go to waste. The effectiveness of maintenance will depend on the ability to create an honest and working government system with the appropriate incentives for the people engaged in it. China seems to have been doing much better than many other poor countries in this regard. One thing that is of major importance in the Swedish case is that government institutions are essentially non-corrupt and relatively efficient. The general public does not accept that government bureaucrats should be able to enrich themselves on tax money, and even small steps over the line can lead to dismissal and legal sanctions. I am uncertain as to how hard the government in China comes down on corruption among political cadres, but their political future is probably less dependent on the views of the electorate.

Sweden has been among the countries most open to foreign trade, and the institutions supporting the system have long been in place. The country started out as a raw material and agricultural exporter while learning the trade, but once it had done so it could use the institutions and the acquired knowledge to export other more sophisticated goods such as industrial goods. China was until 1978 hardly a trading nation, but since then exports have increased dramatically. And China has certainly moved beyond being a primary commodity specialist, into industrial production. In Sweden, the trading houses that initially were selling raw materials were able to use their knowledge and their trade channels to sell also industrial goods. It seems fair to say that openness has been a crucial ingredient in the Swedish development model. The introvert pattern of development that existed in China before 1978 was certainly not appropriate for growth, although the costs of isolation tend to decline with the size of the economy. Still, we must remember that even today China constitutes a small part of the world economy. In 2003, its GDP in US dollars at current exchange rates was smaller than that of Italy's, and not even 5 times larger than Sweden's (with a population of only 9 million).[2] Free trade makes it

[2] In PPP adjusted terms the picture is different, with China's GDP being second only to that of the USA and 27 times larger than that of Sweden. Even measured in this way though, per capita income in Sweden is more than 5 times higher than that of China (World Bank, 2005).

easier to exploit scale advantages and it is an effective way of controlling domestic market power without forcing producers to produce on an unnecessarily small scale.

Sweden rapidly reached the global technological frontier when it started to industrialise, even if it also relied extensively on the copying and borrowing of foreign technologies. China cannot in the short term move to the international technological frontier in a wide variety of products, but it certainly seems to be closing the gap quite fast. To be able to sustain rapid growth when wages and other costs increase, it is necessary to join the innovation club. This requires good technical knowledge. In Sweden, interest in technology has always been high and the post-secondary school system always provided a good technical education. This should be the priority for China as well.

One example of how adaptive use of existing structures may facilitate growth is the role of energy production in Sweden. The country has an abundance of rivers that were exploited as an energy resource. At the same time, the process industry was building generators and other forms of equipment. These two factors were thus mutually supporting and helped create demand for the technology and the knowledge of how to provide it. These industries also were very successful in the export markets. Sweden thus became very efficient in producing power-generating equipment at the same time as it got cheap energy for the rest of the economy. This is one example of several where there was a complementarity between the state as a buyer, and private firms as suppliers, of equipment. With the state as a stable long-term buyer and a partner that was willing to discuss and develop the relevant knowledge, private firms could grow into major multinational ones (e.g. ABB). Other examples of this type are the links between Swedish Telecom and Ericsson, or the Swedish health system and the pharmaceutical industry (present day Astra-Zeneka and Pharmacia Corporation).

The integration of the world of learning and information could potentially shorten the route to the technological frontier for China. Information is much more easily available and the disadvantages of a peripheral location are reduced. The latter is not self-evident, though, since even IT firms in the North tend to cluster. The attempts by the Chinese government to keep some forms of information out (for example, by trying to

control the internet) may be very harmful to economic growth in the longer term.

The Swedish labour movement has generally been positive to structural change and a liberal trading regime. This is a reflection of their experience of the positive effects on their living standard of that type of policy. However, the dramatic consequences of the current structural changes in China are probably going to be accepted by the population as long as they see rapidly increasing real wages and reasonable job prospects, but once there is a slowdown dissatisfaction may emerge. Since this cannot be channelled through independent trade unions or opposition parties, it is unclear what forms protests could take.

The Chinese economy is still far from homogenous. This means that factor rewards such as wages may vary a lot between sectors or activities, and this has an efficiency cost. Swedish trade unions did try to avoid this by actively squeezing wage differentials that were unrelated to the type of job that the worker was doing. This increased the rate of structural change and real income growth. Whether this will be a feasible strategy in China is debatable, and there is actually now a debate in Sweden as well as to whether this is the right strategy for today. Maybe some regions should accept lower wages to reduce their unemployment problems. Still, it does not seem like a top priority in the short term for China to drive bad firms out of business, when the alternative for labour is unemployment or very poor rural jobs.

The stringent levels of taxation of firms that earlier were pursued in Sweden do not seem appropriate for China either. Most investments in fast growing economies are financed by retained earnings, and as long as there is little in the way of alternative sources of finance it is a high-risk strategy to tax firms too heavily.

6. Concluding remarks

The first and most obvious limitation on the application of the Swedish model in China is the large differences in economic structure and income levels. At present, Sweden has a per capita income of close to US$30,000, while that of China is little above US$1,000. Even if we correct for differences in purchasing power, there remains a large gap. The welfare state in Sweden provided a very limited safety net when Sweden had an economic

standard comparable to that of China today. There are thus choices to be made regarding where to start. With limited resources, it seems sensible to put top priority on the provision of public services like education and health services on a broad scale plus the basic infrastructures necessary for a functioning economy, rather than to provide, for example, generous social insurance to the formal sector employees. It seems reasonable at this stage of development to pursue egalitarianism via the provision of public goods or public provision of private goods such as education and health services rather than to try to achieve equality through an elaborate transfer system of the Swedish type. Still, there is need for some forms of safety net.

We have noted that during the period of industrial breakthrough, Sweden was not too dissimilar from the leading economies of the world, albeit a bit poorer. This meant it catered domestically for a similar pattern of demand as that dominating the world market. The situation in the case of China is here at least partially different, although the economy is moving in the direction of the global mainstream (economically). There has emerged a middle-class and elite that have a consumption pattern that is relatively similar to that of the North, although the bulk of the population are not able to adopt such consumption patterns. This means that even in the case of China it is harmful to try to produce only for the domestic population, since this may mean that firms are locked into a pattern of production that is out of sync with what the world market demands. It will not be the most effective route to create a competitive edge for the supply of industrial consumer goods for the global market.

We noted that Sweden was able to change its capital–labour ratio quite a lot by labour emigration and capital immigration. In the current situation it seems hard to expect the North to open up significantly to Chinese labour emigration. There is an abundance of internationally mobile capital available, though, and China has been very successful in attracting it. Investors at present see China as economically and politically stable, but the experience from, for example, Sweden shows that demands for democratic reform are virtually inevitable once people get sufficiently wealthy. Therefore these pressures will surely build up in China as well, and how they are handled by the political system will be the crucial challenge in the decades to come as also with regard to economic development. In Sweden

the scope for and acceptance of effective debate and opposition is vastly more advanced than what is accepted today in China.

Generally one may conclude that there are some lessons to be learnt from various aspects of the Swedish model, as indeed there are lessons to be learnt from other regions. What make Sweden and the other Nordic countries stand out, though, is the extent of social peace and the comprehensiveness of the welfare state these countries have achieved. However, the foundations of such peace are often country-specific and must evolve out of the local social setting. It is thus not obvious what China can learn from Sweden about how to replicate this important ingredient of their development in the past century. What is more certain is that while a welfare state may be a long-term aim for China, in the short to medium term China needs to focus on the core ingredients of development and to build up a welfare state gradually over a long period of time.

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