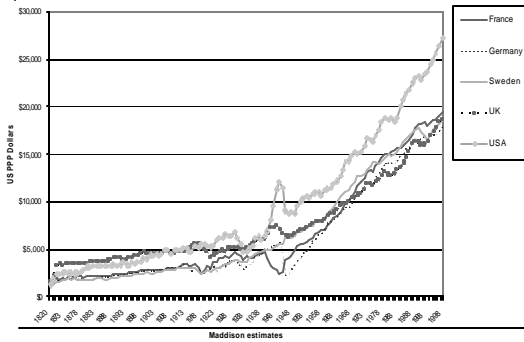


European Capitalism

1. The United Kingdom
2. Republique Francaise
3. Bundesrepublik Deutschland
4. Konungariket Sverige
5. The European Union

Per Capita GDP Performance
Western Europe and the U.S.



The United Kingdom

(England, Wales, Scotland, and Northern Ireland)



Constitutional monarchy:

- > **Monarchy** descended from William the Conqueror, Norman invasion of 1066.
 - > Parliament created with Magna Carta, 1215.
 - > Limitations on crown since Glorious Revolution.
 - > Currently Queen Elizabeth II (since 1952)
- > **Parliamentary system**, bicameral legislature:
 - > House of Lords, House of Commons with Prime Minister.
 - > House of Commons dominant since reforms of early 1840s.
 - > Current prime minister is Tony Blair, Labor Party.
- > **No written constitution:**
 - > Statute, common law, and "traditional rights."
 - > Common law system emerged gradually after Henry II: judicial precedent, equality before law, jury of peers, burden of proof, et cetera.

Data on the United Kingdom

- ❖ GDP ~ \$2 Trillion, world's 5th largest economy depending on year, Euro/Pound exchange rate.
- ❖ Roughly 60 million people (1/5 size of U.S.), densely populated 244/km² (vs 29), 90% urban but majority in small cities.
- ❖ GDP per-capita PPP \$30,300, roughly 72% of U.S. level.
- ❖ Life expectancy 79 years (m=76/f=81) = U.S. level
- ❖ Education: 5.4% of GDP, 16-17 yrs average > US
- ❖ Inequality: GINI=36 (U.S.=41), 10/10=27.7/2.3
- ❖ Economic freedom index =8.8 (U.S.=8.7),
- ❖ Perceived corruption index = 8.3 (U.S. = 7.6)

Some more comparative data:

- ❖ Exports+Imports ~ 60% of GDP (twice U.S.)
- ❖ Central Government budget ~ 40% of GDP (vs. 21% for U.S.)
- ❖ Maximum tax rate ~ 40%
- ❖ Unemployment rate ~ 5%
- ❖ Average inflation rate:
 - UK 1901-45=2.4%, 1946-80=7.0%, 1981-2000=4.7%
 - US 1901-45=1.8%, 1946-80=4.3%, 1981-2000=3.2%
- ❖ Stability - Real GDP ratio c.o.v.:
 - UK 1901-45=0.105, 1946-80=0.042, 1981-2000=0.035
 - US 1901-45=0.189, 1946-80=0.092, 1981-2000=0.033

Historical Context

- ❖ Much of its history was covered in earlier lectures on development of capitalism.
- ❖ As much as any one country, the birthplace of the capitalist economic system.
- ❖ Free trade orientation after repeal of corn laws in 1840s, no tariffs on food or manufactured imports.
- ❖ Great Britain an island nation with early consolidation of strong central government.
- ❖ Until World War II, the U.K. was the largest imperial power (expanding after the defeat of Napoleon), with the world's most powerful navy.

Review World's Growth History

- From 0 AD to 1000 AD:
 - Population grew at less than 0.02% per year
 - Output per capita did not improve
- From 1000 AD to 1820:
 - Population grew at less than 0.2% per year.
 - Per-capita GDP grew at an average of 0.05% per year.
- From 1820 – 2000:
 - Population grew at slightly less than 1% per year.
 - Per-capita GDP grew at more than 1% per year.
- And from 1950 – 2000:
 - Population grew at about 1.8% per year.
 - Per capita output grew at about 2.1% per year.

Growth in the U.K.

- 1700-1870: British growth higher than the rest of the world. World's largest economy in 19th Century.
- 1870-1910: Slowing growth: UK per-capita GDP overtaken by U.S., and others were also rapidly catching up.
- 1910-1950: WWI-WWII, growth still slow.
- 1950-1980: Growth of the welfare state.
- 1980-1990: Thatcher period: scaling back the Welfare State.
- 1990- : Current post-Thatcher period.

Relatively slower growth

(Maddison's estimates)

Per-Capita GDP Growth Rates	UK	USA
1820-1870	1.2%	1.3%
1870-1910	0.9%	1.8%
1910-1950	0.9%	1.7%
1950-1980	2.1%	2.2%
1980-1990	2.4%	2.3%
1990-1998	1.7%	2.1%

Why did growth slow?

- Elitist educational system
 - Class-based "public" schools, anti-business bias
- One-sided trade
- Overseas investment
- Monopolies, restrictions of competition
- Strength of unions:
 - Legislative foundation in 1825
 - Trade Union Congress – unions across trades
 - More radical than in U.S.
 - Rising share (50%) until 1980
- Costs of British Empire
- Losses from world wars – especially WWI
- Overvalued currency due to financial dominance and policy (e.g., revaluation of Pound in early 1920s)
- Governments much more ideological than in U.S.

Growth of the Welfare State

- British history of *laissez faire*
- Beveridge Committee, 1941
 - Fears of postwar stagnation
 - "Comprehensive welfare state" rejected by Churchill
- Postwar Atlee government
- National Health Service
- Nationalization of Bank of England, utilities, coal, steel, transportation, public housing ...
 - First the "commanding heights" – national security, monopolies, and public goods.
 - later money-losing firms to prevent unemployment.
- Limited national planning
 - National Economic Development Council in 1960s – indicative planning, no power, later dismantled.
- Rising tax rates

Criticisms of the Welfare State

- Supply-side effects of high marginal tax rates (83% in 1979) on private sector
- Brain Drain
- Inefficiencies of state ownership:
 - Lack of competition, managerial slack, lack of profit incentive, other competing objectives, et cetera.
- Disincentives of social insurance: Alternative arguments
 - *Voluntary unemployment*: the unemployed *choose* to be on the dole when unemployment benefits are too generous.
 - *Efficiency wage theory*: the unemployed do *not* choose it. Instead, firms pay workers more than market-clearing wages to motivate them. Unemployment insurance means firms have to pay workers even more, which creates excess supply.
- During growth of welfare state, British economy grew faster than before the war, but still declined relative to other developed economies (e.g., U.S., France, Germany, and Sweden).

Thatcher Period

- **Privatization:**
 - Research on relative efficiency
 - British Gas, British Air, BP, British Telecom, Rolls Royce, Jaguar, and many others
 - Revenues of \$30 billion from initial wave
 - Complaints of "discount stock sale"
 - Unemployment?
 - Expected to rise
 - 1970-1980 average unemployment higher than 1980-1990
- **Welfare state left alone:**
 - NHS untouched
 - Continued unlimited unemployment benefits, child allowances, et cetera
- **Tax rates reduced, especially on highest incomes:**
 - Marginal rate reduced to 60% in 1980s, 40% in 1990s
 - Average tax rates not reduced much
 - Government fell in 1990 after effort to create "poll tax"

British Monetary and Fiscal Policy

Pre-Thatcher Monetary and Fiscal Policy:

- U.K. on fixed exchange rate regime (Bretton Woods) prior to 1971 led to accommodative monetary policy to keep interest rates stable.
- Stop-and-go behavior due to conflicting goals of full employment and stable pound.
- Devaluation of Pound Sterling in late 1960s.
- Rising inflation rate after late 1960s -- 28% in 1975 (during a world-wide recession).

Change under Thatcher:

- Emphasis on monetarism, money growth rate reduced.
- Gradual disinflation: 20% in 1980, 5% by mid-1980s, less than 3% by late 1990s.
- Recession in 1980-81, slow growth until 1985.
- In recession, unemployment rose to highest level since 1933.
- Privatization proceeds helped to reduce government budget deficit.

Republique Francaise

- ◆ Monarchy until 1789 Revolution:
 - World leader in science, philosophy, literature, and culture.
 - Centralized state power, especially after Louis XIV: Mercantilism and Dingisme under J.B. Colbert, his finance minister (i.e., Colbertisme).
 - Wide divide between rich and poor.
- ◆ After Robespierre's Reign of Terror, alternating republics and autocracy (e.g., Napoleon, King Louis XVIII, Louis Philippe).
- ◆ Weak Third Republic (1870-1940).
- ◆ Western battleground of two world wars.
- ◆ 1958 Constitution for Fifth Republic, with Strong Presidency (esp. DeGaulle), elected Assembly under Prime Minister, and Senate.
- ◆ Current President is Jacques Chirac, Premier is Dominique de Villepin.



Some Relevant Facts:

- ◊ GDP ~ \$2.0 Trillion, currently replacing U.K. in 4th place (but it depends on the year, since exchange rates vary).
- ◊ Roughly 60 million people (same as U.K., with less than half the density).
- ◊ Cropland ratio ten times greater than either U.S. or U.K., and more workers in agriculture (3% vs. 2%). Higher labor productivity in agriculture, with a strong Farmer's Lobby.
- ◊ GDP per-capita (PPP) \$29,900 (2005 est.), roughly 72% of U.S. level of \$41,800.
- ◊ Life expectancy (m/f=76/83 years) higher than U.S. (m/f=75/81).
- Education: 5.2% of GDP, 15-16 yrs average (=US)
- Inequality: GINI=33, 10/10=24.9/2.5
- Economic freedom index =7.5
- Perceived corruption index = 6.7
- Exports+Imports ~ 55% of GDP
- Central Government budget ~ 45% of GDP, overall spending highest in G-7 countries.
- Maximum tax rate ~ 57%
- High unemployment rate ~ 9%
- Low Inflation ~ 2%
- Unions relatively small & weak (except public sector)
- Firms relatively small compared to U.S., U.K.

Per-Capita Growth in France

(Maddison estimates)

- Prior to 1820, little data available. French average income comparable to U.S., but distribution of income more unequal.
- 1820 – 1870, per -capita growth of 1.0% per year, falling from 70% to 60% of U.K.
- 1870-1913: per -capita growth of 1.3%, back to 70% of U.K.; but investment slowing, vintage of technology and capital rising.
- 1913-1945: average growth of -1.0% due to Great Depression and world wars, down to 33% of U.K. level in 1944 (and 19% of U.S. level).
 - Great concern that slow growth in interwar years would continue.
 - 1940-45 artificially low due to German occupation.
- 1945-1952: Recovery: GDP doubled, back to 80% of U.K. level, 53% of U.S. level (1913-1952 growth average 1.2%)

Growth since 1952:

- 1952-1980: Planning era: continued growth of 3.6%, reaching 117% of U.K. level and 82% of U.S. level.
 - Maddison calls 1950-1973 the "Golden Era" for all western capitalist economies. Per-capita GDP grew by 4.1% (same for France).
 - World economy (with France's) slowed in late 1970s.
- 1980-1990: Socialist Reforms and the Ni-Ni Policy under Mitterrand, growth falling to 1.6%.
- 1990-1998: Cohabitation under Mitterrand and Chirac Presidencies, growth falling to 1.2%.

Indicative Planning

- Influenced by U.S. Aid (Marshall Plan), power of the Communist Party, and Gaullist nationalism.
- Jean Monnet's Planning Commissariat created in 1946:
 - Small bureaucracy – General Planning Commissariat for Equipment and Productivity (CGP) of 50 staff
 - Indicative vs. directive planning
 - Horizontal and vertical "modernization commissions" of business, government, and labor (but dominated by Grandes Ecoles).
- Information, *concertation* and consensus-building, commitment, and consistency.
 - "The process is as important as the plan."
- Cheerleading vs. credibility.
- Can government really do this better than private firms?

Implementation

- Monnet Plan, 1947-1951, 1952-53, focused on recovery, modernization, 6 strategic sectors.
- Harmonizing Plans, 1952-65, expanded plans to other sectors, "relatively accurate" in spite of some conflict with macroeconomic objectives.
- Selection of and investment in one or two "National Champions" in each sector.
- By 1970s, National Plans began to seem more like wishful thinking as they became more complex and began to include social objectives. Loss of credibility.
- Under Giscard d'Estaing, French planning was scaled back to more of a forecasting process.
- Evaluation: Did planning lead to faster growth?

Welfare and Redistribution

- Prior to 1970s, the French had one of the most unequal distributions of income in developed capitalist world.
- New "cradle-to-grave" social benefits:
 - Includes prenatal and maternity benefits, birth grants, monthly family allowances, sickness benefits, medical insurance, pensions, unemployment, disability, and survivor benefits.
 - Railroad workers, for example, retire at age 50.
- Higher government spending and tax rates (highest rate up from 60% in 1970s to 70% in 1984).
- Regulated labor market, high minimum wage, large employer contributions, layoffs difficult.
- Rising unemployment rates (4.4% in 1976, 10.5% by 1987).
- French macro policy characterized by higher inflation from loose monetary and fiscal policy.

European Union and Exchange Rates

- Monnet a leading Federalist, Gaullists wanted to offset U.S. power.
- Marshall Plan required cooperation with other countries.
- France, Germany, Italy, and Benelux the founding "inner six" of the ECSC and then the EEC.
 - EEC policies included the Common Agricultural Policy (CAP), to keep prices high and provide government subsidies.
- However, chronic balance of payments deficits plus an unwillingness to keep holding inflated dollars helped to set off 1971 collapse of the Bretton Woods system.
- Afterwards, France tried to stabilize exchange rates within Europe, but had limited success until 1980s.
- Currently, the French trade mostly within Europe, and run a trade surplus – we will get to why later.

Mitterrand's Socialist Reforms

- Socialist Party won Presidency in 1979, and then won majority of Assembly.
 - Re-implementation and expansion of plan, expanding concentration and contracts.
 - Rapid Increase in nationalization.
 - Labor codetermination (*autogestion*), much from German *mitbestimmung*.
 - Active labor market policies, from Sweden.
 - Expansion of welfare policies.

Nationalization

- State ownership has history back to Colbert, Napoleon.
- Alongside postwar growth of planning system, government began to nationalize and invest in many firms, including those in utilities, insurance, railways, postal service, transport and finance.
 - Nationalized firms prior to 1980s included Air France, Aerospatiale, Credit Lyonnais, Elf-Aquitaine, Renault, and others.
- Largest nationalization program ever in a western democracy began in 1982 under President Mitterrand.
 - State bought 39 banks, two financial holding companies, nine major industrial groups.
 - State paid more than market price to avoid charges of confiscation.
 - State now controlled 52% of investment, 29% of sales, 22% of employment, and 90% of deposits.

The Ni-Ni Policy

- Government expenditures and concern over future helped to create another Balance of Payments crisis, and falling Franc, after 1982.
- "Franc Fort" policy of 1983 focused on tight monetary policy.
 - State control of banking allowed "selective monetary policy"
 - Afterwards, French monetary policy focused on providing stable exchange rate. After creation of unified Euro, monetary policy is controlled by ECB in Frankfurt. Low inflation resulted.
- Mitterrand scaled back nationalization and other socialist reforms to halt crisis.
- Conservatives took the Assembly in 1986:
 - Chirac new prime minister.
 - Privatization announced for 65 firms. Initial revenue was \$50 billion, but 1987 stock market crash halted plan.
- Mitterrand re-elected in 1988:
 - Ni-Ni policy – no more nationalization, no more privatization.
- Fiscal policy also dominated by Euro requirements, including reduction of government deficits and interest rates.

Cohabitation

- Mitterrand vs. Chirac 1986-1995.
- Chirac elected as President in 1995, with Juppé as Prime Minister.
 - More efforts at privatization (e.g., Renault).
 - Failed effort to scale back welfare benefits.
- Socialists re-elected to Assembly under Jospin.
 - Workweek dropped to 35 hours (with no decrease in pay). French currently work less than any other major economy.
 - Unemployment remained high (8-11%).
- Jospin stepped down after 2002 election, replaced by Raffarin, who then stepped down in 2005 after demonstrations on government policy to reduce unemployment by making it easier to fire new hires.

Bundesrepublik Deutschland

- ❖ Federal Republic since 1949:
 - Ceremonial Presidency, currently Horst Köhler.
 - Parliamentary system: leader of Bundestag is the Chancellor (Kanzler), currently Angela Merkel.
 - Federal system: much power retained by 16 Länder/Free States.
- ❖ World's 3rd largest economy. GDP ~ \$3 trillion.



Some comparative data:

- ◊ World's largest exporter (currently slightly ahead of U.S.), surplus.
- ◊ 82 million people – more than France or U.K., though West Germany (the original BRD) was the same size.
- ◊ Density = 235 people per sq. km. (same as the U.K.).
- GDP per -capita roughly 73% of U.S. level.
- Life expectancy m/f = 76/82 years (>U.S. level).
- Education: 4.8% of GDP, 15 yrs average.
- Inequality: GINI=38.2, 10/10=23.7/3.3.
- Economic freedom index =8.0 (U.S.=8.7).
- Perceived corruption index = 7.4 (U.S. = 7.6).
- Exports+Imports ~ 68% of GDP.
- Central Government budget ~ 32% of GDP.
 - but remember it is a federal system. Total government spending is 50% of GDP.
- Maximum tax rate ~ 53%.
- Unemployment rate ~ 12%.

Early History

- They call themselves the Deutsch – Germanii was the Roman term for the northern tribes.
- Unlike France and England, never fully part of the Roman Empire (though in late western empire, Trier served as a northern capital).
- After Charlemagne, Germany was not ever really unified. Holy Roman Empire of the German Nation, 843-1806 (First Reich), was more of a loose Catholic confederation.
 - Voltaire: "neither holy, nor Roman, nor an empire."
- In Thirty Years War, Germany was the battleground between Protestants and Catholics.
- Prior to 1870, Germany was largely a collection of independent regions and feudal principalities.
- In 1848 Prussia was offered the empire, but refused.
- *Zollverein* an early trade union arranged by Prussia.
- Prussia very militaristic, paternalistic, aristocratic, and agricultural.
- Franco-Prussian wars followed by unification of Germany by Prussia in 1871, German Empire (Second Reich) under Kaiser Wilhelm I.

History after Unification

- Chancellor Bismarck's "Iron & Rye" alliance:
 - Protectionism in both industry and agriculture
 - Social security & welfare
- Rapid industrialization and militarization – "blood and iron"
- The Great War, 1914-1918:
 - An assassination in Bosnia, and the Austro-Hungarian Empire vs. Serbia
 - German concerns about Russia
 - France's alliance with Russia and the entry of the British
 - Trench warfare in the West
 - War and revolution in the East – the Treaty of Brest-Litovsk
 - Exhaustion and starvation on the Home Front
 - Entry of the U.S. in 1917
 - Ludendorff and von Hindenburg's spring 1918 offensive – stopped on the Marne
 - abdication of Kaiser Wilhelm II
 - Suspicions of being 'stabbed in the back' by domestic enemies.

Weimar Republic: 1918-1933

- Democratic, but too many parties, weak chancellor
- Reparations and the Treaty of Versailles
- Hyperinflation in the early 1920s
 - From 1920-1923, money supply rose 7.5 million times
 - Prices rose 88 billion times
 - Value of Mark fell to 0.000000000023€
- Fixed exchange rates helped the U.S. pull Germany into the Great Depression
- After 1929, rising power of communists, and the election of National Socialists in 1932 to second largest party
- Appointment of Hitler to Chancellor post in 1933
- Chancellor Hitler's "Enabling Act" after burning of the Reichstag – Weimar Republic dissolved, Hitler becomes "Der Führer" and Germany becomes a totalitarian dictatorship.

The Third Reich: 1933-1945

- Fascism – a militaristic, nationalistic philosophy of Mussolini and others.
- Capitalism with private ownership and markets, central state control and cartelization, direct and indirect intervention, coercive and material incentives.
- Dismantling of labor unions.
- Social face: employment and housing.
- Racism and Eugenics – the "master race" and extermination of Jews, Slavs, Roma, etc.
- Military expansion for "Lebensraum" – Rhineland, Austria, Czechoslovakia, Poland, and War.

Postwar Period

- Division of Germany and Berlin into four zones: British, French, American, and Soviet.
- High inflation, shortages during Occupation.
- New Deutschmark and creation of Deutsches Bundesbank in 1948, plus price liberalization led to a "big bang."
- Marshall Plan – development, not reparations.
- Four "D"s: Demilitarization, Denazification, Decartelization, and Democratization – including the encouragement of unions, political parties, and civil institutions.
- Founding of BRD in 1949 (Basic Law):
 - Konrad Adenauer's mild authoritarianism + Ludwig Erhard's economic leadership
 - Federal system to reduce central power
- Freiburg School of Neoliberalism, under Alfred Müller-Armack
 - Sozialer Rechtsstaat (individual rights, civil law, classical liberal economy)
 - Sozialstaat (justice between groups, interventionism)
 - Neoliberalism – A "Middle Way"

Soziale Marktwirtschaft

Social (*not* Socialist) Market Economy

- Bismarck's welfare state (decentralized)
- Strong, nonradical unions along industry lines
- Labor policies:
 - Labor Regulation
 - Mitbestimmung – codetermination in work councils, supervisory boards
 - Apprenticeships
- Regulated product markets
- Subsidized savings programs
- European Union
- Undervalued currency and support for the Dollar through 1971
- Little state planning
- Little state ownership
- Monetary policy focused on stable currency
- Noninterventionist fiscal policy
- *Gastarbeiter* (guest workers)
- No capital gains taxes or double taxation of dividends
- 1957 Law against limitations of competition
- Small military, decentralized police force
- Export orientation

Real Per-capita Growth in Germany

- 1820 – 1870 1.1% growth (slower than U.S. or U.K.).
- 1870-1913: 1.8% growth, catching up from 59% to 76% of U.K. level.
- 1913-1950: Net growth of 0.3% per year, but big swings:
 - First a 28% net decline during WWI
 - Big drops in 1919, 1923
 - Then 57% net recovery by 1929
 - Then 25% net decline in Great Depression
 - Followed by recovery/militarization – 91% net increase through 1944
 - End of WWII: 60% net decline through 1946
 - During Occupation, a 71% net recovery
- 1950-1973: The *Wirtschaftswunder* – per-capita growth averaged 5% growth per year, and Germany overtook the U.K. by 1961.
- 1973-1990: Slowing growth, but still high – 2.1% average.
- 1990 on: Reunification -- slow growth of 1.1% average (currently about zero)

Reunification

- Soviet Occupation and the German Democratic Republic (DDR)
- End of the Brezhnev Doctrine
- Collapse of Berlin Wall
- State of the DDR's economy
- Exchange rate conversion problem – savings, prices, wages
- BRD labor market regulations
- Privatization under Treuhandanstalt
- European recession, 1992-94:
 - German fiscal deficits, DBB tight money, high real interest rates
 - Fixed exchange rates led to a balance of payments crisis for U.K.
- Unemployment:
 - In West, unemployment rose from <1% before 1964 to 7-9% in 1980s
 - In East, "full" employment before 1989, then 1/3 of workers laid off, 16.5% unemployment in 1992
- Conflict: Ossiess vs. Wessies, neo-nazis vs. gastarbeiter

Kingdom of Sweden *Konungariket Sverige*

- Constitutional monarchy, under King Carl XVI Gustaf
- Parliamentary democracy, unicameral *Riksdag*, under P.M. Goran Persson.
- Politics dominated by SDP since 1932.
- 8.9 million people
- Area = Size of California
- GDP ~ \$300 billion



Some comparative data:

- GDP per-capita roughly 71% of U.S. level
 - PPP never reached more than 90% of U.S. levels, but at official exchange rates Sweden had a higher per-capita income in 1970s
- Life expectancy high: m/f = 77/82 years
- Education: 8.3% of GDP, 14-15 yrs average
- Inequality very low: GINI=25.0, 10/10=20.1/3.7
- Economic freedom index =7.9 (near Germany)
- Perceived corruption index = 9.0 (U.S. = 7.6)
- Very Trade-Dependent: Exports + Imports ~ 87% of GDP
- Central Government budget ~ 43% of GDP
- Maximum income tax rate ~ 31% (was 85% before 1980s)
- Unemployment rate ~ 5.4%

Background

- No invasions, no major migrations.
- After Vikings, never really feudal.
- Early participant in reformation, population mostly Lutheran.
- Great military power in spite of small size from Thirty Years War through 1718.
- Neutral since 1813 (Napoleonic wars).
- Homogeneous population until 1970s; now about 20% are immigrants or have at least one foreign-born parent.
- Relatively homogeneous culture, stronger sense of egalitarianism, less divisive politics, less ideology, more emphasis on cooperation and concensus.

Conflict during Industrialization

- Agricultural economy, slow transition from village to private farming
- Large emigration to U.S.A. from 1850-1890
- Latecomer to industrialization:
 - Conditions for growth began after 1850 (e.g., abolition of guilds)
 - Growth really began after 1870 (Swedish growth 1870-1913 fastest after Japan)
- Highly contentious labor relations:
 - 1898 – LO, Swedish Confederation of Trade Unions
 - 1902 – SAF, Swedish Employers Association
- Split in SDP in 1921 between communists (Left Party) and moderates.

Real Per-capita growth in Sweden

- 1820-1850: 0.2% per year – 55% of U.K. level
- 1820-1870: Growth begins – 1.3%
- 1870-1913: Export reliance – 1.5%
- 1913-1950: Weathering storms – 2.1% (catching up to U.K.)
- 1950-1973: Growth keeps rising – 3.1% (now 120% of U.K., catching up to U.S.)
- 1973-1990: Slowdown – 1.6% (U.K. catching back up)

Government intervention

- During Great Depression:
 - Early interventionist fiscal policy.
 - Early departure from gold standard – along with U.K. and Norway – prevented Sweden from following U.S. into monetary collapse. Price level targeting replaced fixed exchange rate for awhile.
 - Unemployment never exceeded 8%.
- Basic Agreement (Saltsjöbaden, 1938)
 - Initial focus on rules, negotiations to bring peace to labor relations
 - After WWII, centralized collective bargaining
 - Framework agreement over wage share, working conditions
 - Less leapfrogging, reduction of conflict
- After WWII, establishment of the Swedish Welfare State – arguably, the most generous in the world

Stockholm School (Rehn-Meidner Policies)

- EFO Model – focus on international competition
- Wage share bargaining:
 - Unions supported productivity gains, and move away from low-wage technologies.
 - Disincentive for higher education.
- Active Labor Market:
 - National Labor Market Board – centralized job information
 - Recruitment subsidies
 - Retraining and relocation
 - Public works during recessions, transition periods
 - Micro fiscal policy – not aggregate demand stimulation

Savings policies

- Public pension funds – codetermined management
- Public equity capital – employee funds for private investment
- Reserve fund system for stabilization:
 - Tax incentives for deposits with Riksbank
 - Spending approved by NLMB
- High savings rate fueled capital investment.

Welfare Policies

- Generous subsidies to families
 - maternity, children, childcare, education, health insurance, disability, retirement, et cetera. Workers also receive five weeks of vacation.
- Progressive taxation
 - in 1970s, 62% average tax rate for single earners, 71% top marginal rate.
- Unemployment replacement ratio high – 60% in 1970, above 90% after 1985
- Incentive problems, including brain drain, underground economy, high sick days
- Unemployment remained relatively low through 1980s
 - From 1990 to 1994 it rose from less than 2% to 10%
 - Since then it declined back to less than 4% (now 5%)
- Labor force participation rates are also very high

"In Sweden, a large fraction of women work in the public sector to take care of the children of other women who work in the public sector to care for the parents of the women who look after their children." – Sherwin Rosen

The Swedish Paradox

- Consensus vs. competition: "... human relations not based on the laws of the jungle."
- A "middle way" attacked during the Cold War by both the left and the right.
- Impressive economic performance through 1975, largely driven by high-tech, high quality exports.
- High productivity and high employment in spite of all the theoretical incentive problems.

Slowdown in Sweden

- After 1971, Sweden continued to maintain stable exchange rate against major trading partners – leading to importing inflation.
- 1975 World Recession followed by effort to insulate economy with monetary and fiscal policy. Exports fell.
- Rising inflation, unemployment, and government deficits. SDP out of power 1976- 1982. Conservative government nationalized steel, shipbuilding.
- SDP returned in 1982, devalued Kroner → export-led rebound, deficits turned to surpluses.
- Wage-price spirals, continued inflation and devaluations.

Sweden/U.S. Foreign Exchange Rate
(Swedish Kronor to One U.S. Dollar)



The 1990s

- 1991 Moderate Party coalition (Bildt) – more laissez faire, social welfare cutbacks, tax cuts.
- 1992 European monetary crisis:
 - Government defended Kroner (overnight rates rose to 500% annual rate in Sep.)
 - Unemployment rose to record highs
- SDP returned to power in 1994 (Carlson)
 - Sweden joined EU in 1995 and pegged to the DM
 - Still not part of the Euro currency area
- Growth slowly recovered to moderate 1-2%, with low inflation and unemployment

Where from here?

- Some aspects of the Swedish model are dying:
 - EFO model broke down due to rising public sector unions.
 - Effects of high taxes and wage solidarity on incentives has led to some scaling back.
- Continuing debate between “traditionalists” and “renewers” over future policies, now linked to EU/ Euro debates.
- While even SDP has backed away from extreme Swedish model, there is still wide public support for welfare policies, government intervention, and equality.

The European Union

- Historical precedents - empires, Prussian Zollverein
- Aristide Briand in 1920's - "federal links" for European states
- U.S. view in FDR's administration: Interventionist approach to "save capitalism from itself"
- Cordell Hull and the link between trade and peace
- 1944-46 Creation of the Benelux Free Trade Area
- 1948-52 **Marshall Plan** required participating European governments to organize and cooperate to ensure funds weren't wasted.
- In France, coalition of Gaullists and Federalists (e.g., Jean Monnet) - views towards US

The ECSC, EEC, and EFTA

- **Treaty of Paris - European Coal and Steel Community (ECSC)**, 1951 – German Ruhr coal fields for French industry
 - Six countries - France, Germany, Italy, and Benelux
 - American encouragement even though ECSC was against U.S. domination
 - US unsuccessfully encouraged UK to participate, but UK had just nationalized coal industry
- **Treaty of Rome - European Economic Community (EEC)**, 1957 – "inner six"
 - common market (no internal tariffs on goods)
 - supranational institutions
 - Common External Tariff (CET) in 1960s to prevent trading around high tariffs
 - Common Agricultural Policy (CAP) - high food prices
 - UK had low tariffs on food and did not want to participate in CAP
 - Joint Float Agreement - 2.25% bands on internal currency fluctuations - failed
- **European Free Trade Area (EFTA)**, 1960 – "outersix"
 - UK, Denmark, Sweden, Norway, Austria and Portugal - gradually added more countries
 - no CET or CAP

Expanding the EEC

- UK changed its mind about the EEC, but the French opposed their entry
- In 1973, the UK finally joined the EEC, together with Denmark and Ireland
- At the same time, the EEC moved one step further in political integration, and became the **European Community (EC)**
- The **European Monetary System (EMS)**, 1979 – revived the Joint Float Agreement and made it workable with creation of:
 - European Currency Unit (ECU)
 - Exchange Rate Mechanism (ERM) - which tied monetary policy to exchange rates
- From 1981-86, the EC added Greece, Portugal and Spain, now became the "Twelve"

A more complete union?

- In 1987, the **Single Europe Act** was passed – 282 directives for removing economic barriers
- Problem of independent fiscal and monetary policies not possible with fixed rates
 - Three "pillars" of cooperation/integration
 - 1) economic
 - 2) foreign policy / national security
 - 3) justice and home affairs
 - fourth pillar of social cooperation not applied to UK
 - timetable for free flow of labor, capital, monetary union
- In 1991, the **Maastricht Treaty** was negotiated – a goal of a unified Europe.
- 1992 European Financial Crisis
German interest rates caused UK, Spain, Portugal to withdraw from the ERM

European Union (EU)
created in 1993



- Political institutions include European Council of top leaders, European Commission (the "College"), a Council of Ministers, European Parliament, Court of Justice, et cetera.
- Fears of a "fortress Europe"
- "...a family of democratic European countries, committed to working together for peace and prosperity. It is not a State intended to replace existing states, but it is more than any other international organisation."
- In 1995, Austria, Finland, and Sweden joined.
- Ten new countries joined in 2004.

Was the Economic Union Successful?

- European Internal Trade, adjusted for inflation, was nine times higher in 1986 than in 1958.
- European External Trade was 4 times higher.
- By 1987 Europe traded more externally than either the US or Japan.
- Politically?
 - Currently 25 countries, soon to add more in Easter Europe (e.g., Romania, Bulgaria)
 - Conflict over Turkey.

European Monetary Union



- Euro - official currency of 12 member state beginning in 1999
- Stage One began in 1991, Stage Two in 1994
 - European Central Bank - dominated by Deutschmark, and thus by the DBB
 - Convergence criteria to remove outliers relative to best performers:
 - sustained low inflation
 - low budget deficit
 - sustained stability in ERM bands
 - low interest rates 1995
 - only Germany, Ireland, and Luxembourg met all four criteria by 1997 – launch delayed until 1999
 - Banknotes and coins circulate starting in 2002
 - Early value, depreciation, and appreciation
 - Possible effects of the Euro on the US Dollar
