

# **The Swedish Model (1938-1970): A Variation of Capitalism**

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**Abstract:** In the early 1970s, Sweden's unique cultural institutions and competitive presence in international trade fueled Europe's most prosperous economy. Sweden was the second-wealthiest economy as measured by per capita GDP with virtually no cyclical unemployment. For decades, due to its elaborate and highly developed welfare state, scholars misinterpreted Sweden as having a socialist economy. Contrary to common assumptions, the famous Swedish Model was more market-oriented, deregulated, and free from direct government ownership. A process of negotiation and reason, mixed with pragmatism and recognition of valuing opportunity over ideology, produced extraordinary results. Capitalist and pre-industrial cultural forces dominated Swedish commercial practices. The Swedish Model behaved as a market-based system that incorporated traditional cultural characteristics and pragmatism to produce what can be called "feudal capitalism."

*The Nordic model of capitalism means being open to globalization but protecting people from its negative aspects and providing everyone a good, egalitarian education.*

*-Jorma Ollila, CEO of Nokia, to the Financial Times.<sup>1</sup>*

## **Introduction**

By many accounts, between 1870 and 1950, Sweden experienced the world's fastest labor productivity growth rate.<sup>2</sup> During this transformative period, a unique blend of economic policies contributed to what became known as the Swedish model. Joseph Schumpeter observed that Swedish capitalism succeeded due to intrinsic cultural qualities within its financial and political institutions:

*"Sweden...like her art, her science, her politics, her social institutions...owes their distinction not to any peculiar features of principle or intention, but to the stuff the Swedish nation is made of and to its exceptionally well-balanced social structure."<sup>3</sup>*

America's fascination with the Swedish model originated during the Great Depression. In June 1936, with Marquis Childs's best-selling *The Middle Way* on his desk, President Roosevelt held a press conference to announce a commission to study Sweden's system.<sup>4</sup> Initially viewed as a compromise between socialism and capitalism, the Swedish model served as a source of inspiration to America's economic identity crisis. This paper will show that Sweden's model functioned as a series of compromises, but was inherently a variation of free market capitalism imbued with residual feudalistic characteristics that were championed by socialists.

The Swedish model emerged from a societal response to industrialization which emphasized stability in combination with free enterprise. The model buffered its labor force from negative market shifts, by offering paid training to upgrade its workers' skills.<sup>5</sup> During slower periods, firms rotated employees between work and training schedules in accordance with

<sup>1</sup> Milne, Richard. *The Financial Times*, March 23, 2009. "Champion of Nordic Capitalism." Pg. 5.

<sup>2</sup> Maddison, 1982.

<sup>3</sup> Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper Torchbook, 1962), 325.

<sup>4</sup> C. Vann Woodward, *The Comparative Approach to American History* (Oxford: 1997), 302.

<sup>5</sup> *Financial Times*, "A Quest for Other Ways," March 16, 2009.

business cycles and times of the year. Dirk Schumacher of Goldman Sachs observed, “The social welfare system reduces worker anxiety and enables the economy as a whole to restructure.”

In 2010, Finance Minister Anders Borg said the Swedish model was characterized by a large public sector, generous social insurance systems, high marginal income tax rates, an active labor market policy, an elevated degree of unionization, and a well-coordinated wage bargaining system.<sup>67</sup> Economist Assar Lindbeck credited Sweden’s institutional features, not its income or wealth distribution efforts, as to what made the Swedish model unique.<sup>8</sup> The fast rate of productivity growth also proved compatible with government spending increases.<sup>9</sup>

### **Folkhemmet: The Heart of the Swedish Model**

In 1928, Social Democratic Party leader Per Albin Hansson made his indelible mark on Swedish history by presenting the ideal of *Folkhemmet*: “the people’s home,” by which a well-organized economy would provide for everyone’s needs. Hansson’s inspirational image of *Folkhemmet* later grew in importance as the world economy soured and nearby communist and fascist aggression<sup>10</sup> threatened Sweden’s survival.<sup>11</sup> Hansson implored that all Swedes should feel a patriotic duty to build a “people’s home.” Gøsta Esping-Andersen argued that Hansson successfully used *Folkhemmet* as a visual device to unify Sweden’s working classes.<sup>12</sup>

Strong social pressures, a holdover from small-town agrarian village life, dominated Sweden’s psyche. Before 1930, most economic policies were adopted to solve immediate, practical problems. Pragmatism and consensus-building were held in the highest esteem. Though

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<sup>6</sup> Anders Borg, *The Swedish Model: What Went Wrong?* (Stockholm: Ministry of Finance, 2006).

<sup>7</sup> Lindbeck, 1975.

<sup>8</sup> Assar Lindbeck, “The Swedish Experiment,” *Journal of Economic Literature* 35 (September 1997): 1273-1319.

<sup>9</sup> *Ibid.*

<sup>10</sup> Communist Russia invaded Sweden’s eastern neighbor, Finland, in 1939. Fascist Germany invaded Sweden’s western and southern neighbors, Norway and Denmark, in 1940.

<sup>11</sup> *Time*, “Sweden’s Dynasty: Seven out of Seven of Their Neighbors Have Been Raped,” April 29, 1940.

<sup>12</sup> Esping-Andersen, *Three Worlds*, 67.

socialists initiated *Folkhemmet*, industrial leaders, after receiving promises of long-term, predictable profits from the unions, actively contributed to its formation.<sup>13</sup>

Peter Swenson argues that Swedish industrial leaders, having already established themselves a few decades earlier, shared a common interest with unions in securing long-term financial prosperity. In the 1930s, twenty or so families owned most of Sweden's industries, effectively providing the bulk of the country's higher wage jobs.<sup>14</sup> Since *Folkhemmet's* economic vision included giving all workers<sup>15</sup> medical benefits, old-age pensions, and unemployment protection,<sup>16</sup> Finance Minister Ernst Wigforss recognized the necessity of promoting export revenue from selling its manufactured goods and raw materials to other industrialized nations. Germany, in particular, demanded a good portion of Sweden's available iron ore, timber, and other raw materials.<sup>17</sup> Such export sales would boost employment and fund workers' benefits, while also ensuring profitability.<sup>18</sup>

### **A Tradition of Trade**

An innovative element of the Swedish model was its emphasis on how labor and management responded to the world market. Sweden's geographic position and features contributed to forming an economy that greatly valued the exchange of goods. Since the Viking era, Swedes navigated the Baltic and North Seas and beyond in search of commercial opportunities. With a modest domestic market, for centuries, Swedes depended on export revenues. Since Sweden's harsh environment and scarcity of some resources made it impossible

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<sup>13</sup> Swenson, *Capitalists Against Markets: The Making of Labor Markets and Welfare States in the United States and Sweden*, 2003).

<sup>14</sup> These companies also provided many high wage service-oriented jobs which fell under union control.

<sup>15</sup> Later, this included all Swedes.

<sup>16</sup> Tunander, Ola. "Swedish-German Geopolitics for a New Century – Rudolf Kjellén's 'The State as a Living Organism'", *Review of International Studies*, vol. 27, no. 3, 2001.

<sup>17</sup> Gerard Aalders and Cees Wiebes, *The Art of Cloaking: The Case of Sweden Ownership. The Secret Collaboration and Protection of the German War Industry by the Neutral*. 1996.

<sup>18</sup> The town of Boden, for example, functioned as a fortress to fend off a potential Soviet land invasion.

to adopt an autarkic trade regime, import-export commerce steadily continued during medieval times via the Hanseatic League.

In the 18<sup>th</sup> and 19<sup>th</sup> centuries, mercantilism followed by industrialization increased Dutch and British traffic into Sweden, while trade with Germany continued to expand. Since Swedish is a Germanic language, Germans and Swedes can easily understand each other, which greatly facilitated trade relations. Even in its earlier stages of industrialization, Sweden's domestic economy could never absorb what its factories, mining facilities, and lumber mills could produce. Exportation of these materials and products to foreign markets was necessary to assure financial prosperity.

Heading into the 20<sup>th</sup> century, Sweden's international trade, as measured by value and volume of exported goods, rose dramatically. With the overall economy dependent upon international trade, Sweden's policies were sensitive to foreign commercial relations. For example, every proposed trade policy took into consideration of how their trading partners and potential trading partners would react. Despite domestic socio-economic and political changes, Swedish leadership maintained a consensus in support of sustaining international trade opportunities.

Public works spending represented another component to the Swedish model. Upgrading and expanding the nation's core infrastructure yielded more jobs and greatly stimulated internal commerce by linking many small towns that previously endured winter months in near isolation. In 1933, despite having a newly elected socialist government,<sup>19</sup> labor was paid open market rather than union wage rates.<sup>20</sup> Soon, the vastly improved railway, highway, and coastal port networks greatly increased the distribution of goods, people and ideas throughout the country.

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<sup>19</sup> Hansson's Social Democratic government began on September 23, 1932.

<sup>20</sup> Arneson, *Democratic Monarchies*, 237.

Later into the 1930's, government infrastructure spending and military purchase orders increased to further boost employment while also better preparing Sweden's ability to respond to unexpected economic and political demands from Germany and other trading partners.

Another characteristic unique to the Swedish model is how it concentrated on practical rather than principled matters. Though Sweden is endowed with plentiful forests, less than ten percent of its total land was useful for substantial agriculture. Periodic food shortages until 1918 and an acute sensitivity to a scarcity of certain resources evoked a spirit of pragmatism that reminded Swedes of their vulnerability. Such hardships prompted a need for agricultural independence by boosting productivity, removing yield restrictions, and offering subsidies to farmers. In doing so, Sweden achieved agricultural self-sufficiency while also slowing down the urbanization process. These efforts diversified Swedish employment and productivity.<sup>21</sup>

Being financially depended on interacting with the world market, the Swedish model, with the exception of agriculture, was committed to free trade policies. Functioning as an export-driven economy, Sweden accepted its role in supplying raw materials and goods to much larger, diverse economies including Germany, the U.K., and the U.S. By 1939, due to increased commercial export revenue, cyclical unemployment, which had reached 25% in 1932, virtually vanished.<sup>22</sup>

The focus on accountability, another characteristic of the Swedish Model, persisted. Not only did politicians understand that stimulus spending would be short-lived, but sunset clauses were formalized and agreed upon prior to a policy's implementation.<sup>23</sup> Thus, practical reservations dictated the process and shelf life of most government spending. Wigforss

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<sup>21</sup> The Swedish government did briefly attempt to protect the textile industry, especially at the cottage level — and another example of a pro-feudal policy — but this did not last.

<sup>22</sup> Some argue unemployment was “cured” by Germany's large purchases of Swedish exports in preparation for war.

<sup>23</sup> For example, in 1932, the Farmer's Party forced the reduction of proposed deficit spending on public works, intended to stimulate employment, from 160 to 100 million Swedish *kronor*.

selectively targeted fiscal spending by authorizing the duration of particular programs or projects.<sup>24</sup> These Keynesian-like policies reduced cyclical unemployment while also building an extensive infrastructure that functioned as a long-term investment, yielding benefits for many decades beyond the global depression.<sup>25</sup>

Though some cases directly aided existing export-related firms, most projects enabled the further expansion of Sweden's export market. Port facilities, for example, were upgraded and increased in number, which boosted Sweden's export capacity (especially with Germany). As the 1930's progressed, new programs were developed to stimulate private sector investment. Rather than directly controlling investors or taxing them, the government introduced tax code provisions which included deductions, credits, deferments, and exemptions, as well as incentives for businesses to place their profits in the Central Bank.

The government's incentive efforts culminated with the 1938 Investment Reserve Act, which gave firms tax-free investments. All business income channeled back into investments became tax deductible. At the same time, dividends paid to preferred stock holders and institutional owners became tax exempt.<sup>26</sup> This tax policy also facilitated the consolidation of existing firms by giving tax credits for merger and acquisition costs.

Although the government favored the labor movement and nominally advocated socialism, almost all of Swedish capital remained private. Instead, the government influenced the production and distribution of goods and services through regulation, taxation, price controls, and social programs.<sup>27,28</sup> For example, residual agrarian and Lutheran ethics reinforced the belief

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<sup>24</sup> Edvinsson, *Growth Accumulation*.

<sup>25</sup> John Kenneth Galbraith wrote in *A History of Economics: The Past as the Present* that Wigforss's pre-Keynesian policies eventually contributed to increasing Sweden's tax rates. Yet this did not happen until the 1960's.

<sup>26</sup> Shares of stock were divided into two classes, one for institutional ownership and the other for profit-sharing. The class of stock for institutional ownership was consistently given preferential treatment.

<sup>27</sup> [www.geocities.com/CapitolHill/2418/Folkhemmet.html](http://www.geocities.com/CapitolHill/2418/Folkhemmet.html)

<sup>28</sup> Marquis W. Childs, *Sweden: Where Capitalism is Controlled*. 1934.

that the less fortunate deserved some form of public assistance.<sup>29</sup> In 1934, the Riksdag created a state-subsidized unemployment insurance known as *Socialstyrelsen*.<sup>30</sup> To minimize financial strain, unemployment funds collected from payroll taxes paid for the insurance plan. All Swedish workers, if laid off, could then depend upon *temporary* social insurance. In addition, Social Affairs Minister Gustav Möller required every *kommun* to create exchange offices where the unemployed could find job openings.<sup>31</sup>

The Swedish Model relied on a cultural respect for expertise. Political leaders valued input and met regularly with industrialists and economists to carefully coordinate fiscal policies. Bo Lundgren, the former head of Sweden's debt office, noted, "Sweden is less nationalized than most people think. Socialist Sweden never dared tell the banks how to lend or where to lend, because that is a management decision." This observation explains why the Swedish government could support banks and industries, but would never get involved with running them.<sup>32</sup>

Since the Swedish Model respected the value of specialization, few industries were nationalized. Government officials possessed the foresight to allow industrial leaders to do their jobs. Swedish business analyst Dag Detter explained, "private companies must operate with commercial objectives, be insulated from political interference, and be transparent in their actions to maintain the public trust. If any of these three principles are ignored, taxpayers will suffer."<sup>33 34</sup>

### **The Pact of Saltsjöbaden, "The Basic Agreement of 1938"**

The Basic Agreement, though having a central role within the Swedish Model, was not a

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<sup>29</sup> Ibid. 125.

<sup>30</sup> Ibid., 226.

<sup>31</sup> Ibid., 227.

<sup>32</sup> Tett, "US is Ready," 24.

<sup>33</sup> The *Financial Times*, March 18, 2009.

<sup>34</sup> Meidner and Rehn advocated nationalization, but the trade unions rejected this position in negotiations.

governmental institution or a legislative act, but represented an understanding between two opposing well-organized factions within Swedish society. It functioned well because Sweden's once nearly homogeneous population of less than 7 million fostered cultural solidarity. For example, Social Democratic leader Hjalmar Branting attended Uppsala University with King Gustav V (then crown prince). During their college years, despite having vast ideological differences, the two became friends and maintained a cordial relationship for the rest of their lives.

Cultural solidarity, as part of the Swedish Model, was evident when unions first appeared in the 1880s and 1890s as grassroots movements, which formed more spontaneously than in Germany or the U.K.<sup>35</sup> Though unions represented labor, they did not necessarily perceive the redistribution of wages and profits as a zero-sum gain. Instead, unions sought to boost the community's overall welfare rather than their own narrow interests. For example, when a new factory opened, workers reacted by organizing groups to represent the community's collective interest. Unlike other countries, Swedish unions became legal entities, separate from political parties. Sweden's LO (national labor organization), formed in 1898, usually functioned independently of politicians.<sup>36</sup> Branting and other socialist leaders consented to this division as being practical, and a matter of specialization.<sup>37</sup>

Despite rapid industrialization, as late as 1913, Sweden's per capita income remained one of the lowest in Western Europe.<sup>38</sup> Yet, also in 1913, efforts persisted to boost workers' standard of living by creating a universal old-age pension.<sup>39</sup> Another initiative, the Poor Law of 1918,

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<sup>35</sup> Edvardsson, Anders, 2009.

<sup>36</sup> Ibid.

<sup>37</sup> Tilton. *The Political Theory of Swedish Social Democracy*, 1991.

<sup>38</sup> Edvinsson, *Growth Accumulation*, 209.

<sup>39</sup> Erik Allardt et al., eds., *Nordic Democracy: Ideas, Issues, and Institutions in Politics, Economy, Social and Cultural Affairs of Denmark, Finland, Iceland, Norway, and Sweden* (Copenhagen: Det Danske Selskab, 1981), 406.

gave every *kommun* financial support to directly assist anyone in need.<sup>40</sup> Such efforts to boost workers' benefits eventually led to the Basic Agreement, or the Saltsjöbaden Agreement, which formed a wage solidarity policy and fostered an environment that sought to avoid labor conflicts.

Although technically not legislation, the 1938 Saltsjöbaden Agreement acted as an ongoing, informal arrangement for future wage negotiations between unions and employers. The process functioned outside of direct governmental supervision and ushered in a new form of industrial relations — embodied as the so-called “Saltsjöbaden spirit” — which underscored a willingness to cooperate and a mutual sense of responsibility to respond to world market changes. Until the 1970s, this unofficial understanding between unions and employers proved largely satisfactory. Michael Roskin lists the Basic Agreement's key points:

- 1) No strikes are allowed while a contract is in effect.
- 2) Wildcat strikes<sup>41</sup> are illegal; those engaged in them are liable to only civil penalties.
- 3) Labor and management must negotiate disputes.
- 4) Management lockouts of workers are prohibited.
- 5) Secondary boycotts are severely limited.
- 6) Both sides *must* fulfill their contracts, no matter for how long a term they run.
- 7) Whole industries come under one contract.
- 8) The unions cannot block industrial modernization or replacing men with machinery.<sup>42</sup>

The Saltsjöbaden Agreement instilled a process of consultation and negotiation that became *de facto* governance. For example, during *remiss* a Commission of Inquiry is required prior to any major change in the laws affecting a given industry. The Saltsjöbaden arrangement created its own Labor Court, partially staffed by union appointees, which mediated contract disputes and negotiated future deals.

The communication process implemented by Saltsjöbaden's guidelines ensured that all participants, including politicians, were aware of the practical realities that each industry faced.

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<sup>40</sup> Knoedler, Sackrey, and Schneider, “The Middle Way.”

<sup>41</sup> “Wildcat strikes” are labor strikes done without permission from union leadership.

<sup>42</sup> Roskin, *Other Governments*, 28.

Since Saltsjöbaden required that each side receive advance warning of any significant action, it allowed ample opportunity for negotiations. Usually, opposing sides quickly came to an agreement to prevent disrupting revenue flows.

Saltsjöbaden netted positive results, which included more solidaristic wage policies and minimal losses of worker productivity. For example, while Italy and the U.K. became paralyzed with strikes, Sweden suffered fewer strike days between 1936 and 1976 than any Western European country except Switzerland and West Germany. Roskin explained how moderation on both sides allowed Saltsjöbaden to function so well: “Swedish labor does not try to bring the country to a halt and Swedish management does not try to sweat workers.”<sup>43</sup>

Stable employment and material security were promised in return for labor promising not to strike. The collective bargaining process meant that employers provided more benefits and raised wages as revenue increased. Consequently, high and uninterrupted productivity kept customer costs for Sweden’s exports relatively low, yielding a steady international demand for Swedish goods. Childs observed, “So long as the industry privately owned up to 90 percent or 95 percent, it continued to increase its prosperity.”<sup>44</sup>

Swedish industrial and labor leaders commonly believed that economic security meant maintaining and creating employment. The resulting solidarity developed into what Huntford called “corporatism.”<sup>45</sup> Yet, worker and employer cooperation to manipulate the market for their benefit was not entirely new. The Basic Agreement behaved as an updated variation of medieval guilds, whose craftsman and merchants exerted considerable influence on commercial interactions. However, a key distinction persisted in that guilds operated in a slower, more insulated market environment. Medieval domestic and export markets changed at a glacial pace

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<sup>43</sup> Ibid., 29.

<sup>44</sup> Childs, *Sweden: The Middle Way on Trial?* 1980.

<sup>45</sup> Huntford, *The New Totalitarians*, 86.

due to global market conditions taking much longer to affect local production and total revenue. The Basic Agreement behaved as a modernized guild that served feudal “corporate” interests, while also incessantly paying attention to rapidly changing world market conditions. Thus, feudal and market-based elements fused, resulting in a new variation of industrial capitalism: feudal capitalism.

World-market fluctuations and the growth of external commercial connections were so obviously beneficial to all involved that no one, not even Swedish communists,<sup>46</sup> seriously attempted to alter trade policies for fear it would disrupt their positive current account balance. Tingsten argued that Marxist impulses were heavily diluted by Swedish cultural institutions, particularly from Lutheranism which promoted individual accountability and responsibility.<sup>47</sup>

Economic growth, it was assumed, would create more private jobs and, consequently, produce more tax revenue to fund government programs.<sup>48</sup> Though employers had limited authority to fire or lay off workers, labor leaders pressured employees to perform well to earn their wages. High-quality work, combined with high hourly productivity rates, helped union leaders justify demands for higher wages and better benefits. The Lutheran ethos of doing an honest day’s work meant that Swedes rarely did poor quality work to warrant a reprimand. From 1945 to 1965, according to Swanson in *Capitalists Against Markets*, industrial leaders generally could count on a consistent level of profits.

## Conclusion

Tension from the global depression and World War II impelled labor and employers to

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<sup>46</sup> Referring to the present-day *Vänster*, or Left Party.

<sup>47</sup> Tingsten. *The Swedish Social Democrats*, 1973.

<sup>48</sup> Numerous sources indicate that tax hikes were geared toward middle-income wage earners. In effect, workers collectively paid for programs that were designed for them. This was not a wealth or income distribution scheme, at the beginning. Instead, these earlier fiscal policies were designed to help those who funded them. Therefore, government money was derived from pooled resources instead of redistributive transfers of income and wealth.

unify their efforts. In the 1930s and 1940s, Riksdag members carefully scrutinized fiscal policies. Facing internal and external strife, this comparatively small nation<sup>49</sup> had to cautiously manage its resources to survive. Sweden could not afford to succumb to advocating raw quantitative government spending without focusing on its qualitative impact. By maintaining an active role, SSE economists persuaded the general public and the government to spend money in ways that would yield long-term favorable results: what mattered was how the money was spent.

From 1940 to 1970, the Swedish Model succeeded in eliminating cyclical unemployment. The Swedish work ethic initially prevented workers from taking state-mandated entitlements for granted. Structural unemployment was minimized by paying laid-off workers their full salary while attending job training programs to update their skills. Financed mainly by payroll taxes, wage-based income taxes, and the VAT, the Swedish model eventually provided all Swedes with unemployment insurance, a full pension by age 60, universal health care, free child care, child allowances, subsidized private housing, a free university education system, and numerous other benefits.

With the tacit assurance that *Folkhemmet* would be financed by taxing income instead of wealth, Sweden's industrial elite<sup>50</sup> cooperated. Socialist leaders, despite having an ideological aversion to inequalities of wealth, honored their deals with the large companies. They did not adopt a capital gains tax until 1995. Finally, an element of luck enabled the Swedish Model to function so well in that Swedish industries, unharmed by wartime activities, enjoyed a first mover advantage in being able to immediately export finished and raw products. It would take nearly a generation before Japanese, German, and other competitors seriously threatened Sweden's share and position within the world market. In conclusion, the Swedish Model, which

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<sup>49</sup> Statistiska Centralbyrån (SCB), [Swedish Census Bureau], 1940.

<sup>50</sup> Childs observed in 1936 that labor leaders were more inclined to cooperate with business owners.

was best reflected in the Saltsjöbaden Agreement, represented a cooperative spirit that served as the foundation for a unique form of capitalism.

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