Gunnar Eliasson
Bengt-Christer Ysander

Sweden: Problems of Maintaining Efficiency Under Political Pressure

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Activities

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Board

Address

Industriens Utredningsinstitut
Grevgatan 34, 5 tr, S-114 53 Stockholm, Sweden
Tel. 08-783 80 00

CHAPTER SIX

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Industrial policy can work in two different directions. It can be oriented towards improving the market process by stimulating competition and making price signalling more reliable, thereby leaving decisions regarding investments and production in the hands of the firms. The other approach consists of direct interference in the micro-decision machinery of industry through legislation, controls or direct ownership.

Swedish policy towards manufacturing used to be almost entirely of the first, anti-monopoly, kind. But, since the end of the 1960s, Swedish industrial policy has moved in the second direction and the creation of Statsföretag (SF) can be viewed as part of this change.

Swedish industry entered the post-World War II period in an extremely favourable position. Modern and intact industrial production machinery driven by cheap hydro-electric power could supply much needed investment goods to the war-damaged countries of Europe. At the same time Swedish basic raw materials — iron and wood — enjoyed rising prices. These advantages were reflected in a fast generation of resources, a high proportion of which was reinvested, producing an exceptionally fast growth of gross national product (GNP). The Swedish policy orientation until the end of the 1960s was in fact rather to check strongly expanding industrial investments to make room for activities considered socially more desirable, like public sector growth or residential construction.

From the peak of the Korean boom, however, the competitive situation of Swedish industry began to deteriorate. New competition emerged in Europe, America and the Pacific which resulted in falling price trends for Swedish staple goods. The downward trend was temporarily halted by an investment boom in the late 1950s and the early 1960s. Trade liberalisation, economic integration in Western Europe, the lifting of internal war-time restrictions on and impediments to industrial investment and construction were driving forces behind a revival of growth through the middle 1960s.

During this period of industrial expansion and fast productivity increase the Government did little to influence the direction of industrial development. The industrial policy strategy was to facilitate structural change by smoothing its social effects. Government and unions aimed at subjecting the manufacturing sector to further competitive pressure while concentrating on redistributing the rapidly growing output through increasingly ambitious public budgets.[1] Profits and losses remained with industrial owners and business tax rules were generous as long as profits were reinvested in industry. A tight fiscal policy that diverted resources to public sector growth, combined with a union policy of equalising wage levels from below across firms, regions and industries (the so-called 'solidaric' wage policy), served to pressure manufacturing firms into increasing productivity — or going out of business. An *active labour market policy*, directed towards regional pockets of unemployment created by this squeeze, at the same time helped to speed up geographical and professional mobility. These policies included retraining as well as financial stimuli for workers to move geographically. Emphasis, furthermore, was on internally financed expansion within big firms favoured by generous fiscal write-off rules, while a tougher tax treatment was accorded the small businessman who tried to keep his business within the family.

Around the mid-1960s the growth effects of the investment boom had petered out. New international competition was on the increase and the ongoing deterioration of the competitive position of Swedish basic raw-material industries again became visible. With hindsight the mid-1960s can be said to mark a change for the worse in trends for Swedish industry.

Other producing sectors had shown a quite different development. The normal growth in demand for education, health care and old-age security that comes with an increased standard of living had been further stimulated by increased subsidy programmes. Since the production of these sectors was almost 100 per cent in the public domain this meant strong growth in the public sector. In this way, a dual economy was created with a decentralised and privately organised manufacturing sector producing internationally traded goods contrasting with a centralised social service sector.

There were also other sectors that were, to a great extent, in the public domain. The construction sector was strongly influenced from the demand side by government housing subsidies and by a growing share of local government and cooperative ownership of residential buildings. After World War II, the credit system was used more strongly to divert household savings to other uses than manufacturing investment. Formally under private ownership, the banking system, through regulations and controls, came to be more or less in the public domain. Public control of the credit system was further enhanced in 1960 by the creation of a supplementary pension scheme (the ATP system) with a huge funding arrangement (the AP funds). The three initial funds were later supplemented with a fourth, designed to operate as part of a new industrial policy strategy by direct acquisition of shares in companies. This huge financial institution (the four funds) was imposed upon a highly regulated capital market. As a consequence the AP funds, to a large extent, became the main source of cheap (below the market interest rate) finance for the housing sector.

With the continued integration of the Swedish economy with the other economies of the Organisation for Economic Cooperation and Development (OECD) in terms of trade, production and investment, however, a parallel financial integration followed that began to make itself felt towards the middle of the 1960s. Fiscal and monetary policy making in Sweden was no longer solely a domestic issue.

From the late 1960s, the still growing social and redistributional ambitions were thus straining the resources of an industrial engine whose conditions were deteriorating both internally and externally. Politicians and professional economists alike, however, both seem to have been largely unaware of this at the time.

Two alternative ways of responding to changing economic conditions were available to the government in principle — if indeed it wished to react. The old policy of *market support* could be both modified and strengthened to create a more favourable climate for new and aggressive industrial ventures. The alternative was a *selective industrial policy*, that is, more central government involvement in the production machinery and less reliance on the self-regulatory mechanisms of the markets.

The market support policy would probably have required a major restructuring of the capital market and an improvement in the relative benefits allowed for private share owners. The combined effect of accelerating income taxes and tax laws that favoured profit flow-back of capital gains and reinvestment at the expense of dividend distribution worked well during the favourable conditions of the 1950s. Relative — as well as absolute — price development was then quite stable and predictable and investment went, as it should, to those industries where profits had been generated. In the new, changing, competitive situation, however, the same system began to pull the growth machinery into reverse. Cash flows — later reinforced by subsidies — were channelled into long-term losers like the iron mines and the steel and shipbuilding industries.[2]

To provide resources for the needed industrial restructuring, the expansion rate of the public services would probably have had to be moderated. The growth of public consumption — for example, of 'medicare', education, public transport, city clearance — accelerated in the first two decades after World War II, adjusting upward to the fast GNP growth rate. This expansion kept going and even further accelerated during the slow-down of industrial and GNP growth during the 1970s. In the early 1970s, income redistributional ambitions by way of the income tax system were moreover drastically raised which in later inflationary years led to severe distortions in the capital market.

The Swedish Government, however, opted for the alternative of abandoning piecemeal its general policies *vis-à-vis* the manufacturing sector. To begin with, this consisted of new policy approach measures, explicitly designed to overcome deficiencies in the capital market and perceived restrictions on the supply of industrial finance. These measures could not be said to be part of a consistent policy programme but were, rather, the result of *ad hoc* responses to the current and unfamiliar economic situation. To some extent, official documents of the time do reflect worries about the increasingly competitive international environment. This, however, was by no means the only, or dominant, political concern behind the new policy approach.

Of at least equal importance was the increasing anxiety about the social costs of expansion. Environmental damage, regional imbalances and social distress associated with rapid structural change are emphasised in the documents of the time as the most important reasons behind the policy revision. The new regional policies of the mid-1960s constituted the first deviation from the old Swedish policy model.

The concentration of industrial power and also, possibly, of private industrial wealth resulting from increasing scale and specialisation were also in the forefront of political discussion at the time. Demands for a more direct representation of labour and of the public interest in the boardrooms of private business were frequently voiced from the beginning of the 1970s and eventually materialised in the form of changed legislation.

As part of the new industrial policy orientation, a set of new institutions for more active government intervention and participation has been organised in the following areas: (i) planning procedures; (ii) financial resources; (iii) company laws; and (iv) state companies.

An organisational structure for a central coordination of industrial development, somewhat similar to the French plan, emerged in the late 1960s. In 1969 a new Ministry for Industry was formed out of a separate department already set up two years earlier within the Ministry of Finance (Treasury). Attached to this new Ministry was an advisory industrial council and associated with this were several branch committees making reconstruction plans for the branches of industry most acutely affected by the new international competition. In 1973 this work on detailed studies and sector programmes was incorporated into a new industrial agency (Industriverket). Meanwhile, responsibility for technological and industrial research had been delegated to another new agency, STU, set up in 1968. The development of the organisational structure for industrial policy soon was followed up by a similar structure for regional development, being integrated at the agency level with the labour market policy and supposedly working in close collaboration with its industrial counterpart.

The creation of new bureaucratic institutions, designed to ease the financing of risk ventures into new industrial fields and to support latent innovations until commercial fruition, had already begun in 1967 with the establishment of the State Investment Bank (SIB). Although assumed to operate according to the normal profitability criteria of commercial banks, the SIB was supposed to enjoy a much greater freedom than the banks when it came to evaluation of long-term risks and demands for bonded security. Through a subsidiary, the SIB could also give financial and moral support to socially desirable industrial mergers.

A Special Development Fund (Utvecklingsfonden) was later added to the group to complement STU (a Department of Industry research and development organisation) and the SIB by offering financial support in the early stages of innovative ventures, that is, between research and production. This development fund was formally a part of the industrial agency (Industriverket). Various financial companies were also set up to accommodate the special needs of small business, like 'Industrikredit', 'Företagskredit' and 'Företagskapital'. 'Regioninvest' was later added (in 1976) to support industrial activities in regionally distressed areas and in particular to ameliorate the side effects associated with the aborted 'steel work 80' project. The Government also attempted initiatives on its own. Through SU — a development company set up in 1968 — unexploited industrial innovations were to get a chance of being presented in the market. Another new state company — Svetab — was set up in 1969 to help in establishing new, state-supported, production companies to turn ideas into jobs.

Two general comments may be added here. It should first be understood that access to long-term capital-market bond and debenture finance has been selectively regulated in Sweden throughout the post-World War II period. The capital market has been dominated since 1960 by the huge supplementary pension fund; but high risk investments were offered at the same regulated market terms through the special institutions mentioned above. These institutions could thus be interpreted as an attempt to compensate for a possible tendency towards exaggerated risk-aversion or short-sightedness on the part of the Government's own regulations. It did, however, usually go further, implying a form of selective government subsidisation of the costs of credits.

The second comment has to do with the corporate income tax system in Sweden, characterised by generous fiscal write-off rules.[3] Firms have access to interest-free government (tax) credit, the amount of which can be increased through increases in their level of investment. It is an open question whether firms feel a responsibility to earn a market return on the part of their 'implicit net worth' which is made up of this credit or if they simply restrict their ambitions to earning a return on this book-value of assets. The second case implies that firms lower their internal rate of return standards to adjust on the margin to the interest free credit.[4] Capital market dominance and regulation and the corporate income tax system (with special mention of the investment funds) together represent the major vehicles for government intervention in the resource allocation process in Swedish industry, in terms of the resource flows involved.[5]

One of the first tasks of the new Ministry of Industry was to prepare new legislation requiring public representation on the board of directors of all large companies. Two other pieces of legislation and collective agreements arising out of the experience of the 1960s were to have an important impact on the business sector. One was concerned with the security of jobs, making it considerably harder and more costly for a company to lay off labour. The other dealt with internal decision making in a company, requiring consultation with employees and union representatives before taking any action affecting work conditions and job security.

The Government also chose to enter the business sector directly by forming new companies or taking over responsibility from existing firms. There were some bold ventures into so-called 'future industries'. The most typical were computers and nuclear technology — in particular the state half-interest in Data-Saab, Udd-Comb and Asea-Atom. The Swedish Government shared this hope of picking future 'winners' with other European governments like the United Kingdom, West Germany and France. In retrospect, however, the Swedish ventures, like the majority of similar experiences abroad, cannot be judged as successful. The successful government interventions took, rather, the form of the joint development of complex high technology products, either in the form of a development-purchasing contract or by an institutional arrangement like Ellemtel between LM Ericsson and the Swedish Telecommunication agency.

Having encouraged industrial mergers and concentration, the Government sometimes considered it part of its anti-trust responsibilities to have the public interest represented as shareholders in the dominant firm. This was, for example, the case with the new, private cement monopoly, Cementa, formed in 1969. Similar arguments acccompanied a series of government purchases in manufacturing sectors, considered vital to public health or security. The Government thus has bought a majority interest in the dominant Swedish brewery (Pripps, in 1975), purchased a drug company (Kabi, in 1969), established a state monopoly in drug distribution (Apoteksbolaget, in 1971), and has formed a series of new companies for technical testing purposes — Semico and Statens Anläggningsprovning, for example.

The 1970s also witnessed a sometimes heated political discussion on the nationalisation of the pharmaceutical industries — being, by some, considered the natural sequel to government control of the pharmaceutical distribution system — and, on similar grounds, on the nationalisation of commercial banks. Nothing came of this, however.

The rapid proliferation of state businesses soon made administrative control through ministries appear unwieldy. Potential political embarrassment, furthermore, easily emanated from routine business decisions. Considerations of this kind led, in 1968, to the formation of a government business delegation (Affärsverksdelegationen). In some political quarters the aim was that this delegation should develop into a coordinating agency for all government business activities, irrespective of judicial form and activity. Instead, in 1970, a more narrowly defined entity was formed: Statsföretag AB (SF), a state-owned conglomerate under the direct control of the Department of Industry. The board of SF was almost identical to the earlier delegation. The major part of the government-controlled business companies — twenty-two firms in all — were thus bundled together under one corporate hat. Only the main financial institutions and the fiscal monopolies were excluded.

It was hoped, at the time, that with so much of industrial power under government control it would prove possible to push industrial development into socially desirable areas and regions and to increase the influence of works and unions without having to sacrifice profitability. This hope was built on the hypothesis that private industrial power sometimes creates unnecessary social problems by default or neglect even when socially more acceptable and equally profitable solutions exist. The SF, however, never had a fair chance to test the merits of this argument. Structural problems, barely camouflaged during the 1960s and early 1970s, came into the open during the recession of the late 1970s. SF was forced to accept the role of midwife to governmental reconstructions of bankrupt companies, designed to solve short-run employment problems. A series of new 'national' companies emerged in shipbuilding, steel and textiles (Svenska Varv, SSAB and Eiser) with the government as the controlling party.

Only recently, with Svenska Varv forming a wholly separate group and with SSAB as a portfolio interest only, has SF been stripped of non-business commitments to the extent that it may be able to begin acting as a normally operating industrial group. SF top management has also been trying to obtain special government contract offers for activities in what they call 'special programmes', that is, problem industries.[6]

The new industrial policy did not stop either the Government or private business from making bad investments — ploughing back profits or tax-money into long-term losers such as the steel industry — but the experiences of the 1970s taught everyone a costly lesson and have created an opening for new approaches in the 1980s. What the lesson consisted of and how it was learned is very much the story of SF.

CONGLOMERATE OF PROBLEMS: DEVELOPMENT OF STATSFÖRETAG

When SF was formed in 1970, it ranked immediately as number three among Swedish companies in terms of employment, with 34,000 employees. At the end of the decade it was still the third largest company in the country, although now with almost 47,000 employees. Its importance as an employer was matched by its importance as an exporter. More than half of its sales are abroad, making up some 5–6 per cent of Sweden's total exports. SF was initiated as a normal commercial enterprise although it was expected to show special concern for the social effects of its managerial actions — and the ambition of the ruling social democratic party was to develop it into one of the main instruments of industrial policy. In the public mind SF became closely associated with the financial reconstruction and nationalisation of some major branches of Swedish industry. (Table 6.1.)

Table 6.1
Government Share of Total Employment and Investment (per cent)

	Employment (persons)		Investment (gross)	
	1970	1979	1970	1979
Statsföretag AB[a]	0.9	1.1	1.3	2.0
Other state-controlled stock companies (incl. credit institutions[a,b])	0.6	1.8	0.5	2.4
State business agencies	3.7	3.7	6.9	6.5
State services	6.3	7.5	5.2	5.2
Central government total	11.5	14.1	13.9	16.1
Local government joint stock companies	n.a.	0.9[d]	10.6	7.8
Local government business agencies	1.0	1.2	6.4	4.4
Local government services	14.3	22.3	16.6	11.7
Local government total	15.3[c]	24.4	33.6	23.9
Total Government	26.8[c]	38.5	47.5	40.0

[a] The partition of the state-owned companies has been made possible by the use of data from the publication *Statliga företag* (Stockholm: Liber, 1980). As this source diverges somewhat from the national accounts otherwise used, especially in 1970, the figures should be interpreted with caution.
[b] The figures for 1979 include the newly acquired Södra Skogsägarna, previously a production company belonging to the farmers' cooperative movement in forestry. The figures also cover AB Samhällsföretag, a company created for the employment of handicapped people.
[c] These total figures exclude local government joint stock companies for which data concerning 1970 are not available.
[d] The estimate of employment in local government joint stock companies has been derived from data available at the Association of Swedish Local Governments, while the other employment figures have been calculated using official employment statistics from the National Central Bureau of Statistics.

Backdrop of the Problems: the Swedish Economy During the 1970s

Swedish economic policy of the 1970s will probably be best remembered for badly timed demand management which added to the already existing adjustment problems on the supply side. The decade started as it ended, that is, with stagflation and a rising trade deficit. In 1971, the Social Democratic Government, to correct a growing external deficit, braked so resolutely that, combined with a sudden decrease in housing investment and an equally sudden and unexpected increase in household savings, the economy went into deep recession for two years. The economy emerged in late 1972, however, in very good shape to meet the steep recovery in raw materials demand and prices of 1974.

The impact of the international upswing in 1973–74 was reinforced by the raw materials' boom affecting Sweden's basic industrial resources and was further supported by a very expansionist fiscal policy. Swedish export industries experienced a great profits' boom in 1973–75, present in no other OECD country but Finland. Tight fiscal and monetary policies were applied much too late and huge wage increases were let through in 1975–76, coinciding with a sudden collapse of exports and export prices. To prevent a sudden increase in unemployment at home, the government boosted domestic demand *inter alia* by accelerated public expenditures and by paying the business sector to increase inventories and keep employment at normal figures.

This traditional contra-cyclical policy programme was followed through by the new, non-socialist, government that came into office in 1976. But investments boomed in the wrong sectors. Both the business sector and the Government went on a spending spree, partly misreading the market signals. By further expanding capacity in steel, shipbuilding and the petro-chemical industries, new structural problems were added to old ones. As a consequence, the competitive situation for Swedish industry changed dramatically between 1974 and 1976.

From 1970–74 Swedish manufacturing unit labour costs equalled the OECD average and were some 15 per cent under those of West Germany. Two years later the Swedish figure was 15 per cent above that of West Germany and 30 per cent above the OECD average. To maintain profit margins, Swedish firms priced themselves out of many traditional export markets and over the next few years registered a dramatic downturn in market shares, profits and industrial investments.

The economic situation worsened in late 1976, and 1977 saw a series of devaluations. By this means, the new Government managed to rectify most of the overvaluation of Swedish currency. Before that, however, the Government had felt forced to pull several firms out of bankruptcy by various kinds of subsidies. In fact, during the years 1977–78, Swedish industry 'earned' more by state subsidies than it generated as gross profits. Part of this 'profit crisis' can be attributed to the overvalued currency but a large part of the profitability crisis was more permanent or structural. The major recipients of government cash support were the iron and steel, shipbuilding and, later, some forestry industries. In some cases outright nationalisation was the final outcome. For some of these firms the situation was not only disastrous in the short run but, according to many observers, hopeless in the long term too.

Some firms had by then been caught up by their investment spending mistakes in the mid-1970s. In this way, for example, the Government in 1979 acquired a controlling interest in two wood-processing firms earlier owned by farmers' cooperatives. In the same year, workshops especially adjusted for physically or socially handicapped workers, part of which had earlier been financed by relief work grants, merged into one big company (Samhällsföretag), employing around 25,000 people.

Even without the bad timing of demand management, the Swedish economy would have had trouble adjusting on its own with sufficient speed on the supply side. Decentralised market adjustment had become harder to achieve: labour laws made it very difficult for firms to lay off labour, short of bankruptcy, and tax laws made it hard for expanding firms to attract labour through wage offers. Progressive income tax locked labour into the wrong sectors and corporate income laws locked venture capital into the wrong sectors. The result was that the Swedish economy entered the 1980s with an undersized and wrongly proportioned industrial sector.

Statsföretag Charter

Little or none of this was foreseen when SF was initiated in 1970. Official documents emphasised the managerial efficiency advantages and the political gains of being able to delegate specific commercial decisions to the new holding company. Visions of a new industrial policy, however, reappear in the public objectives set out for the new company which were to attain the fastest expansion consistent with a profitability requirement. Another recurring theme in the documents is the hope that the new company, by the power of its sheer size and capital resources, would be able to fulfil particular social and industrial obligations without having to sacrifice profitability unduly.

The new company was to show particular concern for regional employment and the development of new employee relations and working arrangements and it was to support and spread commercial and technical innovations in the industrial field.[7] Execution and financial reconstruction of whole industrial sectors was a task added later. SF in the 1970s thus had five different roles, as: (i) manager of a business conglomerate; (ii) entrepreneur and industrial innovator; (iii) pioneer in employee relations; (iv) trustee of regional development and employment; and (v) official 'receiver' of businesses in need of overhaul and reorganisation. Its performance in each of these roles will be considered in turn.

SF as Conglomerate

SF was faced with several difficult initial tasks as a conglomerate. Its corporate basket contained a very wide assortment of eggs, some oddly shaped. The spread between sectors is illustrated in Table 6.2 which gives the composition of SF in 1970 and 1979. In terms of employment in 1970, the iron and steel subsidiaries made up almost a third and food and tobacco a quarter. In terms of sales, the importance of iron and steel halved over the period while that of wood processing and building materials doubled. Food and tobacco, engineering and shipbuilding commitments also diminished in relative size while the chemical industry and services expanded. A new block of textile firms was added to the group after 1976. Table 6.2 also shows that the financial importance of the so-called industrial development companies has been negligible and thus not at all in proportion with the hopes and headaches associated with them.

The administrative set-up of SF reflects both its commercial ambitions and special social obligations. Of the fourteen board members, one is the chief executive and one represents the Ministry of Industry. The remaining twelve seats are divided equally between the business community and the unions, four of the latter being chosen by the employees of the SF group. The

Table 6.2
Composition of Statsföretag, 1970 and 1979[a]

	Average number employed ('000)		Sales (SKr. million)	
	1970	1979	1970	1979
The SF group[b]	34.1	46.5	3592	12177
Iron and steel	10.6 (31%)	7.7 (17%)	1485 (41%)	2230 (18%)
LKAB	7.1	7.7	1131	2174
NJA	3.4	−339	56	–
Engineering and			171 (5%)	
electronics	2.3 (7%)	5.1 (11%)	8.1	1167 (10%)
Kalmar Verkstad	1.1	1.0	–	339
Kockums Industri	–	2.2		440
Ship building	4.4 (13%)	–	310 (9%)	–
Uddevallavarvet	2.8	–	257	–
Karlskronavarvet	1.6	–	53	–
Wood-processing building materials	4.3 (13%)	12.4 (29%)	585 (16%)	3028 (31%)
ASSI	4.3	9.4	570	2897
Rockwool	–	2.6	–	743
Chemicals	1.2 (4%)	3.6 (8%)	140 (4%)	1528 (12%)
Kabi	1.0	2.5	118	701
Food and tobacco	9.0 (26%)	7.8 (17%)	762 (21%)	1963 (16%)
SARA	6.9	4.6	357	726
Svenska Tobak	2.1	3.2	405	1237
Services	1.1 (3%)	3.5 (8%)	120 (3%)	697 (6%)
ABAB	0.5	2.1	23	192
Liber Crafiska	–	1.2	–	461
Textiles	–	5.7 (9%)	–	719 (6%)
Eiser	–	5.7	–	719
Industrial development companies and others	1.2 (3%)	0.6 (1%)	48 (1%)	156 (1%)

[a] In parenthesis is the percentage of the whole of companies in which SF holds a half interest without having them as subsidiaries.
[b] After internal group adjustment.

members of the executive staff of the holding company are represented on the boards of the main subsidiaries.

The main task assigned to SF was to disburden the Government of ownership responsibility directly related to the operations of individual firms. After the establishment of a holding company, furthermore, it was thought that it would be possible to distinguish between decisions of a more general kind made by the political decision makers in relation to the holding company and decisions of a more operational character made by the holding company in fulfilling its ownership obligation relative to its subsidiaries.[8] A possible interpretation of these rather vague formulations is that the politicians wanted to be protected from blame for unpopular commercial decisions and wanted to avoid the role of hostage to local employment problems.

To judge from the outside how well SF has been able to fulfil this function is extremely difficult. The politicians' wishes to stay away from down-to-earth operational problems may be more than cancelled by their desire to cash in politically on employment-creating investments. Experience in the 1970s seems to indicate that the problem of balancing immediate concerns about unemployment against ambitions to establish a sound economic footing for long-term economic growth is, indeed, a difficult and politically hazardous one.[9]

Alternatively, however, the instructions quoted above might be seen as a way of protecting managers of the state companies from political meddling. At that time, though, the major state companies concerned voiced no need to be 'protected from' their political owners. They were sceptical both of the need for coordination and of the potential efficiency gains to be had by reshuffling profits within an extremely heterogeneous conglomerate. The non-socialist opposition in Parliament expressed the concern that the proposed holding company might become a means of hiding inefficiency.

Whether SF and its staff (of some sixty persons) have been able to protect its subsidiaries from political and/or competitive pressures in any significant way is impossible to tell. SF management has certainly made use of the possibilities of short-circuiting parliamentary intentions by the internal reshuffling of profits. By transferring profits within the conglomerate, SF — like any similarly structured private group — can avoid paying local taxes and tax and dividends to the state.

By this kind of internal manoeuvring, which is a normal practice within large corporate entities, SF has 'disbursed' at least half a billion Swedish crowns of potential local government taxes and more than a billion of potential state taxes, without reference to either Government or taxpayers. Profit flows may be further aggregated by integrating permanent loss operations with subsidiaries generating handsome profits (as in the integration of Sinject into the Swedish Tobacco Company). Whether, and to what extent, this has gone beyond normal and accepted behaviour for a private commercial firm is hard to know: no comparable private conglomerate exists.

One way of insuring SF from political, non-commercial, influence would be to sell it, as a whole or in part, on the equity market — for example, by accepting private shareholders in the state companies and making exchanges of shares in private and state companies a normal procedure. This would ensure adherence to market rate-of-return requirements. The idea was, indeed, explicitly mentioned as an alternative to the setting up of SF by the Conservatives in 1970, echoed in 1978 by the Royal 'One Man' Commission[10] set up to survey the future of SF and again in a publication from the Federation of Swedish Industries in 1980.[11] There has so far, however, been no official attempt to follow up these suggestions.

Another kind of exchange between private and state business sectors, also aiming at the application of tougher internal rate-of-return standards, might be engineered through the buying and selling of individual firms within SF. So far, SF has acquired many firms but sold few. There is, however, no reason to believe that SF does not want to rationalise its rather varied assortment of production lines. Many of the firms purchased have been taken over by SF unwillingly — and only after political prodding — because they were in bad financial shape and there was a lack of presumptive buyers. Moreover, political and trade union considerations do undoubtedly place considerable obstacles in the way of selling off any part of the state business empire on grounds of bad profit performance.

When operating units are as varied as those of SF, some order must be brought into the organisational maze by discovering what firms can gain by being more closely associated. SF has chosen to build sub-groups, or subsidiary units, designed to exploit technical and commercial potential, while the holding company concentrates on (i) finance, (ii) some organisational matters and (iii) more general policy questions. In this way the wood processing group (ASSI) grew rapidly during the 1970s to become a conglomerate in its own right. Many of the management problems of SF have been delegated to this group.

The same kind of managerial technique has been used in attempts by the Ministry of Industry to reorganise entire sectors of industry, such as steel and shipbuilding. In these cases, it has been a major aim to construct a group with a satisfactory balance sheet — or at least one that appears satisfactory — and, then, as in the case of Svenska Varv (shipbuilding) and SSAB (standard steel), to leave it on its own or, rather, to leave it to the mercy of the Ministry of Industry. As will be seen later, the separation of shipbuilding and standard steel production from SF is the major reason for the movement to better profit performance in 1978. (See Figure 6.2 below.)

Undistinguished Innovator

SF's record of industrial innovation and entrepreneurship is less than impressive. This is true whether one looks at the overall production growth of the group or at the specific accomplishments of the industrial development corporations, that were established by SF to generate and transmit innovative impulses to the rest of industry. Sure enough, new ideas have been launched and new products marketed, some of them with startling success — one example is the new truck developed by Kalmar Verkstad. Another — and financially much more important — commercial success is the pipe tobacco Borkum Riff. With this brand the tobacco company has managed to capture 9 per cent of the American pipe tobacco market which is no small accomplishment. As a result, the Swedish Tobacco Company has been able to pay almost three quarters of a billion towards losses elsewhere within the group. This was especially true after the collapse of the iron ore market: before that, LKAB was the main supplier of golden eggs. These examples, however, are exceptions to the general picture which is characterised by a relatively low level of research and development (R and D) expenditure, by few product developments and by remedial action to patch up the results of loss making.

Official statistics on industrial research and development are notoriously unreliable. The proportion of these costs in the budget of the SF group has been somewhat below the level of private firms in the corresponding branches, however. Moreover, the group's R and D efforts seem to have been directed more towards basic research and process improvements than to market-oriented product developments. Compared with the rest of the business community, SF group companies on average seem to pay more for outside patents and to earn less on patents of their own.

The industrial development corporations Svetab and SU have been involved in regional employment problems from the very start. In this way they became heavily engaged in, and responsible for, a number of small and middle-sized firms, most of which were to become financial burdens rather than development resources. By the time SF took over final responsibility for them, around the early and mid-1970s respectively, each employed between one and two thousand people and they both faced major financial problems. SF managed to untangle their affairs by selling off some of the small firms and by distributing others to the care of more solvent subsidiaries. SU was reconstructed as a small central advisory group focussing on industrial techniques for energy conservation. The investment function within Svetab was decentralised to four regional venture capital companies charged with the task of engaging on a minority basis in innovative ventures within the regions.

It soon became clear, however, that SF could not function as a leader of industrial advance. Too much of its time was used in fighting rearguard actions for industries falling behind. There is a general lesson to be drawn from this. Instruments designed for very long-term purposes should perhaps be kept out of reach from decision makers whose concerns and preoccupations naturally tend to be more focussed on the problems of the immediate future. This was also one of the original ideas behind the forming of SF.

The Model Employer

SF was also charged with special obligations of coordinating and representing the state employers in the business sectors and of being a pioneer in the new methods and arrangements in employee relations. The state, as employer, was expected to give both authoritative interpretations and an exemplary execution of the new laws dealing with labour security and labour participation. Particularly during the last few years SF, by all accounts, has put much effort into educational and experimental activities within the field of personnel relations. Due to the circumstances in which SF has found itself, much of this work has been concerned with finding ways and means of compensating, training and re-employing laid-off workers. Unfortunately, there are as yet no studies of how this activity of SF compares with that of private firms.

Trustee of Regional Development and Employment

From its birth, SF, was charged with special obligations for regional development and employment, in particular in Northern Sweden where most activities in basic industries, like mining, steel and wood processing, were centred. The official goal — or illusion — was that regional interests could be taken into account in decisions on sites and sizes for investment, without any effect on profits.

Reviewing the past decade, there is no doubt that considerations of regional employment have weighed heavily in many of the investment decisions made by SF. It is equally clear that some of these have proved very costly in terms of profitability. Examples have already been cited. By far the most important, however, is the capital sunk into steel and shipbuilding. A combination of employment considerations and over-optimistic forecasts of foreign and domestic demand were the main reasons behind an expansion and modernisation of steel capacity at NJA in Luleå.

In the middle of the 1970s the Government was even on the brink of adding a huge plant to the one already existing — very much against the advice and desires of SF management. This so-called 'steel work 80' project produced great political turmoil in Sweden. Although these plans were finally scrapped, the money put into the northern steel works up to 1978 corresponds to a capital consumption of some 75,000 Swedish crowns per man per year, if the figures carried on the balance sheets are accepted. Swedish shipyards are currently subsidised to the tune of 2,500 crowns per taxpaying household per year. The government-operated shipyards are, however, no longer part of the SF group.

Here again, there are more questions than satisfactory answers.

In some instances SF undoubtedly managed to stave off immediate local unemployment. What SF did to the long-term regional employment situation is, however, far less certain. Nor is it possible to compare the results of the money invested in selective industrial measures with the gains that would have accrued from more general policies, such as regional differentiation of business taxation or of the collective labour fees born by employers.

Structural Surgeon

SF is, no doubt, by now best identified with its role as official receiver and surgeon-general of industrial sectors in need of financial reconstruction. The major examples of this are the reconstructions of shipbuilding, standard steel and textile industries from which emerged the new state-controlled business groups Svenska Varv, SSAB and Eiser. In all three cases the final 'nationalisation' was carried through after a series of earlier supporting measures had failed to put the industries back on their feet. The magnitude of the task and of the money involved was such that responsibility for the major decisions automatically fell back on the Government which used the SF partly as a technical and financial intermediary and partly as a means of unloading a responsibility it did not want. The distinction between being a structural surgeon and a dump for impossible political problems in industry is, therefore, extremely thin. The unloading in 1978 of two of the worse cases — the northern steel plant and the shipyards, to SSAB and Svenska Varv respectively — may, however, indicate the strength of SF top management ambitions to be a commercially viable company.

From the very beginning the new selective industrial policy contained both defensive and offensive ambitions. The offensive ambitions were concerned with finding new avenues for industrial expansion by, for example, funding and transmitting innovative ideas and providing the risk capital necessary for the new ventures and industrial combinations. The defensive purpose was to deal with the social costs of structural adjustment by better tailoring industrial investments to the needs of regions and the wishes of employees as expressed in active participation. The offensive aims were soon thwarted by the turn of events, partly brought about by the Government's own bad timing of demand policy. As the problems created by currency over-valuation, domestic inflation and a profitability crisis grew, so did the clamour for more selective measures and subsidies. SF was a major instrument of these selective measures and had to foot part of the bill.

In spite of the difficulties of evaluating the overall (social and private) performance of SF in terms of stated objectives, the Royal Commission of 1978 expressed its conclusion in the following terms: 'Even though stated objectives and ambitions [about] maximum expansion subject to a profitability criterion', about the 'contribution to industrial expansion' and to 'activities where size, risk and long-term commitments are central' and about employment *et cetera* were not fulfilled, the current economic situation would have been even 'more difficult to control with the earlier organisation of government business activities. It was therefore appropriate to form SF'.[12]

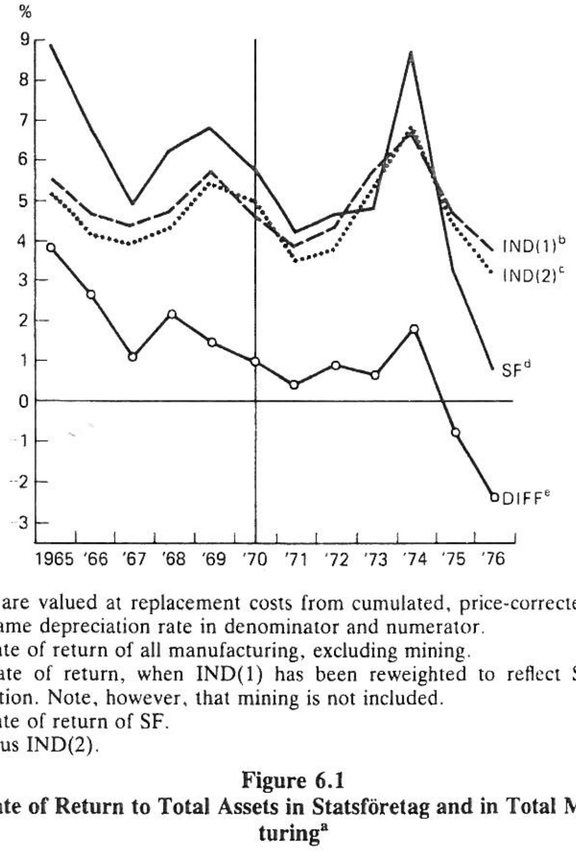
COMMERCIAL AND/OR SOCIAL PROFITABILITY: RESULTS OF STATSFÖRETAG

The SF group provides an excellent example of the intricacies involved in profitability analysis. But what does profitability mean in a group that initially earned large profits from rents on capital that traditionally is not fully (or at all) activated in the books; a group that turned into a heavy and seemingly permanent loser? The best examples are the 'stock of forests' and 'the mine deposit' in the north. How should capital be valued in such a group?

Profit Performance of SF

Due to generous fiscal write-off rules, assets in an average Swedish manufacturing operation as recorded in the books are normally considered to be under-valued compared with the real market value. But this is not so for SF — at least after 1975. Assets in shipbuilding and standard steel operations, net of formal debt, have no market value. SF would in fact have to pay to get rid of some of its assets, at least as long as an employment responsibility was attached.

The standard procedure is to calculate real rate of return figures, as in Figure 6.1, based on replacement values for plant and equipment. One common procedure is to cumulate investments from the past, corrected for inflation and net of depreciation. In Figure 6.1, the rate of return has been calculated in a way comparable to similar calculations for all industry. One curve (SF)



[a] Assets are valued at replacement costs from cumulated, price-corrected investment. Same depreciation rate in denominator and numerator.
[b] Real rate of return of all manufacturing, excluding mining.
[c] Real rate of return, when IND(1) has been reweighted to reflect SF sector composition. Note, however, that mining is not included.
[d] Real rate of return of SF.
[e] SF minus IND(2).

Figure 6.1
Real Rate of Return to Total Assets in Statsföretag and in Total Manufacturing[a]

shows the real rate of return, before tax, on total capital in Statsföretag. This can be compared to the same measure [IND (1)] calculated for all manufacturing. The third curve [IND (2)] gives the same real rate of return for total manufacturing reweighted to obtain the same branch composition as SF. The data on 'SF before

1970' have been calculated from the accounts of all the large firms that were bunched together as SF in 1970.

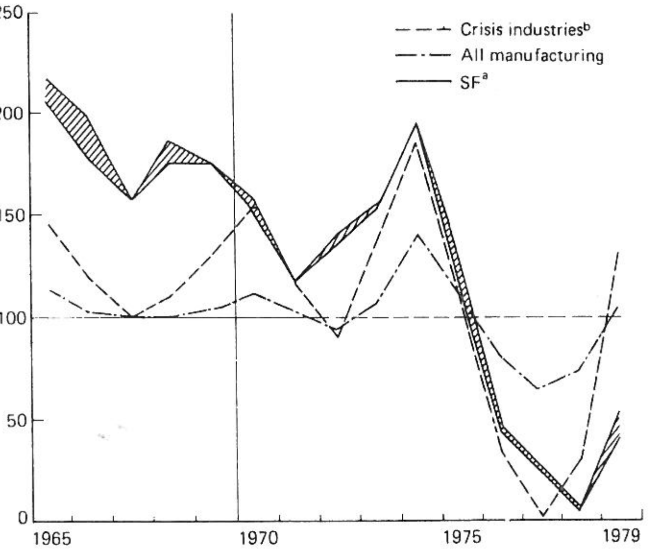
The official target set for the SF group in 1969 in fact was to expand within a 'satisfactory' profitability constraint. What satisfactory profitability meant was not very clearly stated but the two measures defined above could be used as a reference.

The difference in Figure 6.1 between the SF real rate of return and the reweighted rate-of-return measure for all manufacturing is positive until 1975: SF's performance is quite good until 1975. After 1975 LKAB losses, in particular, reduce SF's real rate of return strongly. Due to lack of data, mining is not included in the total industry measure. As far as we can see, however, there is no evidence in the Figure to suggest that SF was not a well-run company compared with the average Swedish manufacturing firm with the same sector mix, at least up to 1976. Inclusion of mining in total industry figures would probably reduce the positive difference before 1975 and reduce the negative difference thereafter. Mining has a much greater weight in SF than in manufacturing as a whole and its impact on SF performance is heavy.

The rate-of-return curves in Figure 6.1 were constructed by way of a flat rate of depreciation. What does this mean to a long-term loser like SF? The real rate of return calculated in this way tells a sad story of very bad profit performance. Suppose, however, that this is due to a few large investment mistakes. The company will then have to await the end of a slow depreciation process to show good profitability figures, even though current operations are quite profitable. Why not cut the permanent losses immediately through writing off all dead capital? In a company with SF's background of relying on the commercial capital market this would have happened long ago through bankruptcy or financial reconstruction.

This can be reformulated as follows. Suppose all investments in SF have been a complete waste of resources: they have no capital value and should be written off the books.[13] Does SF have an earnings potential after this financial surgery? With no depreciable assets on the books a relevant profit concept is the gross operating profit margin. Does it show a positive contribution and what are the future prospects? Gross operating margins of SF are shown in Figure 6.2. The same pattern appears here. Until 1975 the SF index developed well ahead of the manufacturing average. Then it nose-dives together with the other crisis industries. It does not recover until SF has managed to divest itself of standard steel and the shipyards in 1977 and 1978.

When we know how much the Government paid, the next question to ask is what the Government had hoped to get in return



[a] SF profit margins have been measured both in terms of sales and valued added. The difference is, however, negligible.
[b] Crisis industries are defined as mining, steel, forest industries and shipping. There is an interesting accounting device in the shipping profit series. Despite large losses, adding shipping to the crisis industries increases profit performance in the years 1976–79. The reason is probably that ships being built or ships completed but not sold are entered at cost plus a reasonable mark up in the profit and loss accounts; when sold at a staggering loss, they appear as a write-off.

Figure 6.2
Profit Margins in Statsföretag, Crisis Industries and All Manufacturing (100 = 1970–79 average)

for the money. How much of the money was considered a normal commercial investment and how much was paid to get other policies executed or to get SF to perform special duties?

Winners and Losers

The winners in the post-oil crisis situation are easily counted. When ASSI and LKAB became seemingly permanent-loss operations after 1975, the task of propping up financially was taken over by the tax payers, by the Swedish Tobacco Company and by an odd assortment of other companies. The Swedish Tobacco Company is partly a government monopoly but, as noted earlier, has succeeded in becoming a profitable export company in pipe tobacco. KabiVitrium, the pharmaceutical company, recorded a steady flow of profits until 1978 and seemed to be a future winner, with high research and development spending and a good-looking mix of advanced products. It over-extended itself, however, and went into a slump in 1979[14] from which it is now slowly recovering. Kalmar Verkstad has been very successful in producing and selling heavy trucks. Positive profit contributions have also been recorded by the publishing company Liber. Liber, however, thrives on an implicit monopoly arrangement for government printing and publishing. The chain of restaurants, SARA, went through a tough rationalisation programme in the early 1970s and is now a profitable business.

Net current losses over the decade were very much concentrated in particular firms. Udd-Comb, the nuclear reactor subcontracting firm, accounted for about 200 million Swedish crowns in losses and NJA, the standard steel plant in the north, for more than 800 million. These figures would be much larger if losses from the early part of the 1970s were upgraded to take account of inflation; however, they are peanuts in comparison with the big losers. SSAB (the new standard steel group, including NJA) and Svenska Varv (the new shipyard group), both publicly owned but now separated from SF, generated losses of 670 and 1,650 million Swedish crowns respectively in 1978 alone.[15] For SSAB this amounted to 15 per cent of turnover and for Svenska Varv almost 35 per cent.

Financing Investments

Throughout the 1970s both the value of sales and the book value of capital in the SF group trebled. To expand, SF needed a great deal of new financing. Taken together, for 1971–79 more than 17.5 billion Swedish crowns of external finance was used. 1.25 billion of this went into covering losses within the group, so that 16.25 was available for capital accumulation, of which around 11.5 were investments in buildings and machinery and 3 billion for inventory increases. About 1.25 of the remainder was invested in shares *et cetera*, much of it in connection with the financial reconstruction of the steel and shipbuilding industry. The remaining half billion is accounted for by increases in financial assets and net purchases of new firms.

The amount of real investment sunk into SF is undoubtedly high, even taking into account the capital intensity of its major firms. Again, the investments are very much concentrated in a small number of firms. The main part of investment expenditure was in LKAB, ASSI, NJA, Berol Chemicals and the shipbuilding firm, Uddevallavarvet. The rather unfortunate allocation of part of this investment money has already been noted: throughout the 1970s, and especially during the investment boom in the mid-1970s, more than a billion crowns was sunk into a shipbuilding yard and into a new plant for basic chemicals both of which are still showing a very unsatisfactory return, while more than 2 billion crowns was invested in the steel works at NJA in Luleå. If we accept the book value of 700 million at which NJA was sold off in 1977 to the newly established SSAB, the capital consumption at the steel works in Luleå was of the order of 2.3 billion crowns between 1971 and 1977. The investment boom of the mid-1970s was common to all industry. The major share of the investment boom, however, occurred among the crisis-stricken industries (mining, steel, forestry and shipbuilding), accounting for about 40 per cent of manufacturing investments and in the relatively profitable engineering sector. SF, itself heavily burdened by crisis industries, followed the investment path of the crisis industries but did not cut investment spending enough in 1977, in spite of a much earlier drop in earnings.

Of the financing needed in the period 1971–79, 7 of more than 16 billion crowns were contributed by the state, either in issues of shares or in other forms, while 5½ billion were taken up as loans. Some 800 million crowns were obtained by selling off assets. The wide divergence in the profit performance of the subsidiaries is again evident, with the Swedish Tobacco Company as the leading profit maker, LKAB second and ASSI third. NJA is the great loser. There was a substantial shifting around of profits in the form of intra-group subsidies, together amounting to some 1½ billion crowns over the decade. The dramatic change that has taken place between the first and the second half of the 1970s, however, is the transformation of the principal cash provider of the early 1970s (mining operations) into a long-run problem for the SF group.

Equally interesting is the development of investment spending within the group. There is a perverse relationship between investment and profit contributions. Not only did low-performance subsidiaries receive a relatively higher contribution of total finance for investment in the good years 1973–75 but, during the bad years that followed, the low-performance companies and the big losers have been the relatively heavy recipients of investment capital within the SF group. The internal allocation of investment funds within SF thus exhibits an extreme version of the misallocation of resources within Swedish manufacturing during the 1970s. It should of course again be remembered that most of these 'misallocations' are of the 'special programme' type, the enactment of which, for all practical purposes, has been imposed on SF by the Government and, to our knowledge, often against the will of SF management.

To evaluate the degree of government subsidisation, apart from the 7 billion crowns of direct contributions, it is necessary to know how much of the 5½ billion of loans were 'soft' or specially tailored for the needs of the SF group. It appears that most loans were obtained with the usual commercial conditions in the capital market. It is more difficult to judge to what extent the special standing of SF as a big government-owned group made for more easy access to long-term borrowing than is normal for a private firm. What can easily be calculated is that the outside supply of financing has allowed the SF group to retain a slightly higher formal net worth/debt ratio than has generally been possible for the rest of industry.

Government Contract Offers: a New Line of Business

It is particularly difficult for a publicly operated business to adhere strictly to the profit motive. A firm of SF's size cannot close down an unprofitable plant in a regional unemployment area to protect its profits without generating political turmoil. Nor can the Swedish railroad monopoly (SJ) terminate transport services simply on grounds of an insufficient number of customers to cover costs. Thus, a system of government contracts has been used for many years by the railroad monopoly to finance unprofitable transport services. This idea can be — and has been — extended to cover the employment of a certain number of people in a region or the restructuring of a particular loss company.

The problem for the Government is then (i) to determine what the companies would have done were there no such subsidies and (ii) to determine the need for — say — extra transport or employment services. This is no easy thing. The efficient solution is for the Government to put the unprofitable service on the market as soon as SF asks for subsidies and invite competitive offers from both private and public firms. Competitive bidding between several independent companies is essential for this to work, both in the sense of determining the magnitude of the task and in minimising costs.

It still remains, however, to determine how desirable the activity is from a welfare point of view. How much is the public willing to pay for it? If a market for subsidy payments of this kind is to be more than an accounting device, its social net benefits have to be clearly specified and evaluated.

Actual Swedish practice displays a wide spectrum of such subsidy arrangements. Some examples, like the opening of the new mine of Stekenjokk, seem to fulfil the competitive conditions mentioned. On the other side of the spectrum, however, are many cases where the subsidy was tied to a financial reconstruction or was a straight hand-out to cover current losses. As long as there are no strict rules about the use of the offer system, the appearance of the word in various accounts of subsidies does not really help to delineate what part of total subsidies should be considered as payment for special tasks.

For SF, the contract offer system was formally recognised in the bill to the Parliament in January 1980 (prop. 1979 180:79). At the same time the profitability objectives originally formulated in 1969 were repeated and emphasised. Contract offers had also been emphasised in the 1978 annual report as the best method to compensate SF for non-commercial business ventures urged upon it by the Government.

The money disbursed to SF to take care of defunct companies suggests that this is very profitable business. SF, however, argues that this is not a fair assessment.[16] For one thing, the assets of defunct companies usually have no value. SF does not want to write them off against its own profits. Second, the salvaging of defunct companies takes an unduly high proportion of management resources and attention away from more profitable activities elsewhere. Furthermore, SF management does not learn very much from such activities.[17] Third, and perhaps even worse, the very fact that SF engages in these activities means that it becomes even more difficult to apply tough, internal profitability standards elswhere within SF.[18] Fourth, many of these activities have no real business future, even after being rescued and reorganised. To engage in such activities SF wants to be well paid.

It is very difficult to assess the merits of such arguments. Any firm with a profit motive will of course charge as much as the market can absorb. So the problem is rather whether the Government is paying an undue amount of taxpayers' money to a select group of workers in defunct companies.

Kockums Industries (making equipment for forestry work), with 1,250 employees and 385 million Swedish crowns in annual sales, received an equity contribution of 235 million crowns and a 150 million crowns loan with conditional repayment obligations to cover losses in 1980–81.[19] The equity contribution amounts to 190,000 crowns per employee for three years, or almost 75 per cent of wage costs for the three years. To pay out that much, a huge amount of accumulated losses must have been hidden away in the Kockum accounts. There was an immediate outcry from the three competing firms in the market. They argued that the Government, by supporting Kockums, was driving them out of business. If any firm should go out of business, they said, it should be Kockums.[20]

The Eiser (textiles) rescue operation is more explicit on the subsidy purpose. The government bill (prop. 1979–80, 79 p. 25 f) stated that 29 million Swedish crowns would be handed out to keep production alive at 'the Norsjö and Sollefteå' plants from 1 January 1979 to 30 June 1980. These plants employed less than 180 people during that period. The subsidy thus amounted to 160,000 Swedish crowns per employee for a period of one and a half years. This is just about the entire wage sum including all additional charges (retirement fees, payroll taxes *et cetera*). The explicit intention was to maintain production.

CUSTOMER VERSUS TAXPAYER: EVALUATION OF STATSFÖRETAG

After this guided tour of the SF accounts, let us return to the crux of the matter: the customer versus taxpayer confrontation. The taxpayers undoubtedly have had to pay quite a lot. What the customer has gained seems quite unclear.

The non-profitable part of the government-invested capital mostly seems to have gone into (i) ill-timed capacity increases, (ii) the covering of losses on current operations and (iii) the payment of various other tasks of regional and industrial policy. In this way, the taxpayer may have had to subsidise inefficiency within government firms, even though there are, as yet, no signs that such policies have undermined the competitive positions of other firms at home or abroad. It is also far from clear to what extent the objectives of the policy, say more secure employment, have been reached. In several of the sectors in which SF is engaged, there have been complaints by domestic competitors about the unfair advantage of the easy financing enjoyed by the state combine. There are, however, no data to sustain or refute this contention.

Achievements

The original aims of SF were (i) to 'achieve maximum expansion under a minimum profitability restriction' and (ii) at the same time to fulfil a series of social objectives, like improving industrial structure, making the regional distribution of job opportunities more acceptable, softening the unemployment consequences of structural change *et cetera*.

The Royal Commission that was set up to view SF's performance concluded that the first objective (i) was not attained[21] and we concur on the basis of our analysis. As for the second ambition (ii) the discussion here will be restricted to the efforts to keep up employment in especially afflicted locations.[22] Our conclusion may be summarised in the following way. The efforts can be evaluated by asking two successive questions: (i) could SF achieve these results by less costly means and (ii) is there a different and socially less costly alternative?

With respect to the first question, SF management has been systematically pushing the commercial profit motive, often against the desires of its owners. This is illustrated by the fact that the really 'terminal cases' (the shipyards and standard steel plant) have been forced out of the SF organisation and the responsibility 'handed back' to the Swedish Government. With standard steel and the shipyards out, SF exhibits a profit performance that is close to other industries with the same sector mix. The data even seem to suggest that SF has been very skilled in obtaining profitable government contracts to reconstruct ailing firms and to solve short-run unemployment problems. If this has been costly for the Government, the problem is one of government competence that should be solved by a more competitive bidding for government contract offers. Given the charter of SF, its internal allocation of resources has probably been considerably more efficient than would have been the case if the same activity had been organised directly under ministerial control. As to whether there is a different and socially less costly alternative, one could consider the following three alternative suggestions to arrangements of the SF type: (i) a selective subsidy programme with no direct management involvement, or (ii) a general cost-reducing, fiscal policy package, simply allowing the non-viable firms to close down, or (iii) stimulating more private competition against SF for government contract offers.

We cannot here present a thorough evaluation of these alternatives against each other and against SF. Our earlier discussion suggests, however, that a selective subsidy programme must be inferior to the SF arrangement. It would in fact mean returning to the situation before SF was organised, that is, having no profit-oriented financial intermediary between the politicians and the production units. In so far as private firms in distress are to be 'socially managed' during the adjustment period, a politically managed subsidy programme is likely to be more costly than a professional management solution. It may slow down or even worsen the adjustment process and, with or without intention, subsidise lenders to, and share owners in, distressed companies as well.

The second suggestion is exemplified by proposals, often put forward during the 1970s in Swedish policy discussion, to combine currency depreciation with regionally differentiated cuts in the payroll tax and to pay out financial inducements to firms for marginal increases in capital investments and employment. With no subsidies and several closedowns of firms, a temporary increase in frictional unemployment would most likely follow before the growth effects begin to dominate. We think that, with hindsight, most political decision makers would now tend to prefer such a solution. It is extremely difficult to evaluate such policies empirically. We have so far neither a satisfactory dynamic theory nor fully tested empirical tools for such an analysis.[23]

In the third suggestion the Government purchases management competence not only from SF but also from private firms. If the SF administrative solution is a viable alternative to the *ad hoc* handing out of subsidies, then it would do no harm to make a more efficient use of management competence in other firms as well by engaging them on a larger scale in bidding for a minimum cost solution to the social adjustment problems. Furthermore, future SF management teams may not be as good as the current one and may prefer to fall back into more comfortable and politically more yielding behaviour. With no competitors to provide a comparison for its performance, SF may, in the longer run, become less efficient. A further check on SF management of course is to put part of SF equity out for competitive bidding in the stock market. This has been discussed[24] and would be a natural continuation of the current SF management philosophy with its emphasis on market solutions for achieving social objectives.

A LESSON TO BE LEARNT

The story of SF and of Swedish industrial policy in the 1970s, as reviewed above, does not sound very edifying to an economist — not, at least, if economic efficiency is the overriding goal. In the Swedish economy, where factor markets are closely regulated and in which almost two-thirds of all disposable money is channelled through public budgets for reasons other than efficiency, a more complex judgement is needed. Applying efficiency criteria to SF in isolation would be unfair and also wrong. It would be equally misleading to polarise our view so that social motives are the only ones that cause government intervention in the business sector. This is why we decided to introduce and analyse SF in the context of direct state intervention in business management activities.

From official records accompanying the new kind of direct government involvement in business management in the 1970s, we learn that it was originally propelled by high ambitions to improve and innovate. From the records of the 1970s, we can read that such involvement became mostly defensive, supporting declining industries in the hope of getting them back on their own feet. Records of success are restricted to a few activities, notably within SF, where efficiency and profitability stubbornly have been pushed as the overriding objective, often against the wishes of the political governing bodies.

The lessons from the SF story in the 1970s are mostly concerned with proper and less proper ways of handling losers. Any industry contains a tail of losers. Any firm of a certain size has a string of both profit and loss operations. Normally luck shifts around over time but, even so, a careful inquiry would probably show that medium-sized and large firms continue with loss-making operations for years, wasting resources that could have been employed more profitably elsewhere.

One reason for this is, of course, uncertainty about the future: by closing down something a future winner may be lost. The special situation of SF is that the company is paid to continue operating plants whose future is deemed completely hopeless by SF management. The tax payer pays for the extra costs to fulfil a social objective. Such government contract offers are not unique to SF or other public bodies. When a private firm enters the subsidy market the intent, however, is to make a profit *above* the subsidy, at least in the long run. The Swedish engineering combine Electrolux has done that several times by moving its own products into the factories of defunct firms. ('Facit' is a case in point.) Conceivably, this could be a prosperous business part of SF as well. Viewed from this point of view, the optimal policy of the Swedish Government should be to put rescue operations on the market, with as many bidders as possible, in order to secure a minimisation of its subsidy costs. Whether intended or not, a major part of industrial policy so far has consisted of disbursing subsidies to impossible operations to preserve employment in the short run.

One should note that this is just the opposite to a profit-oriented firm or merchant bank that absorbs losses for years on the chance to cash in handsomely some time in the long-run future. Private conglomerates are based on the idea of a tightly reined-in merchant bank and investment institute in combination: they are the extreme form of remote management control and guidance. The efficient operation of such a firm requires delegation through simple measures of performance such as profit controls based on good standardised profit measurement systems.

One is tempted to say that this should be the last organisational form to choose for a politically dependent body like SF. Multiple conflicting objectives like profits and employment responsibilities would jam the decision process. Strictly enforced profit targets on defunct operations do not tally with the presence of elected politicians in the neighbourhood of the decision process. Considering this, it is surprising that SF has performed so well in comparison with other firms and especially during the last few years of crisis. Furthermore, the alternative, where all decisions are passed one by one in a disorganised fashion within the ministries, must surely be an inferior one.

Given the circumstances, the SF arrangement may be a second-best solution — with a first-best fiscal policy, not a politically feasible option — provided a highly qualified and politically independent management team can be rounded up. Since this cannot be guaranteed in advance with the current charter of SF, suggested improvements are (i) to engage private firms actively in the bidding for the 'social offer' contracts performed by SF and (ii) to put SF itself in the equity market to ensure that enough interests are locked up in the profit motive. Praise, however, undoubtedly must go to top SF management that has, so far, performed beyond expectations. A further test of it will come, however, when the northern iron mine and its associated city, Kiruna, may have to be reduced to a fraction of their present size.

NOTES AND REFERENCES

1. The philosophy behind this policy was outlined in several documents from the Central Union Organisation (LO). See, for instance, *Utredningen angående economisk efterkrigsplanering*, SOU, Stockholm, 1944, Nos 7, 12, 13, 25, and 57, and 1945, Nos 11, 30, 31, 36, 42 and 54. See also, *Fackföreningsörelsen och den fulla sysselsättningen* (Stockholm: LO, 1953).

2. See G. Eliasson and J. Sodersten (eds), *Business Taxation and Firm Behavior*, IUI Conference Report (Stockholm: Industries Utredningsinstitut [IUI], 1981) No. 1; and B. Carlsson, F. Bergholm and T. Lindberg, *Industristödspolitiken och dess inverkan på samhallsekonomin*, IUI Working Paper No. 39 (Stockholm: IUI, 1981).

3. Or even ahead of the actual acquisition of a capital good through the renowned Swedish Investment Fund system. See Eliasson, *Investment Funds in Operation* (Stockholm: Konjunkturinstitutet, 1965).

4. See the paper by Eliasson and Lindberg in Eliasson and Sodersten, *op. cit.*

5. At least until the extensive subsidising of failing industries began in the late 1970s. See Carlsson, Bergholm and Lindberg, *op. cit.*

6. These special programmes currently include Berox, Eiser, Kockums, LKAB, Svetab, Udd-Comb and Ceaverken, employing some 35 per cent of SF's Swedish employment in 1979, most of it in distressed regions.

7. For a documentation of these ambitions, see 'Angående ett statligt förvaltningsbolag m m', *Royal Parliamentary Bill No. 121*, (Stockholm: Government Printing Office, 1969), and *Statligt företagande i samhällets tjänst* (Stockholm: SOU, 1978:85).

8. *Royal Parliamentary Bill No. 121*, *op. cit.*

9. That these problems occur on a larger scale in planned economies is demonstrated in J. Kornai, *The Economics of Shortage* (Amsterdam: North-Holland, 1980).

10. See *Statligt företagande*, *op cit.*

11. See N. Lundgren and I. Stahl, *Industripolitikens spelregler* (Stockholm: Industriförbundets Förlag, 1980) pp. 141 *et seq.*

12. See *Statligt företagande*, *op. cit.*, pp. 11–15.

13. Thomas Lindberg at IUI has been very helpful in providing data for this analysis from his research project at the Institute.

14. See *Affärsvärlden*, Stockholm, No. 46, November 1979.

15. See *Affärsvärlden*, No. 20/21, May 1980.

16. See 'Utfragning om Statsföretag', *Ekonomisk Debatt*, Stockholm, No. 4, 1980, pp. 306 *et seq.*

17. See interview with the Managing Director of SF, Per Sköld, in *Affärsvärlden*, No. 40, 1980. See also Eliasson, *Business Economic Planning* (New York: Wiley, 1976).

18. See again interview with Sköld, *loc. cit.*, and the interview with the Finance Director of SF in *Dagens Industri*, Stockholm, 4 March 1980, p. 12.

19. 'Om Kapitaltillskott till Statsföretagsgruppen m m', *Royal Parliamentary Bill No. 79* (Stockholm: Government Printing Office, 1979/80).

20. Complaints were immediately filed with the Minister of Industry by one competing firm (AB Börjes Mek. Verkstad, 28 January 1980), by all competing firms (2 February 1980) and jointly by the unions for workers, salaried workers and supervisors at another competing company (Östbergs Fabriks AB, 12 February 1980).

21. See, for example, *Statligt företagande*, *op. cit.*, ch. 1.

22. *Ibid.*, p. 15.

23. A recent study on the long-term allocation effects of the Swedish subsidy programme using a complete micro(firm)-to-macro-economic model sets a general subsidy programme against a general decrease in the payroll tax costing the same amount in the first year. The subsidy programme tends to stimulate demand in the short-term, increasing the utilisation of inefficient capacity that would otherwise have been closed down. The wages share in total output is higher than would otherwise have been the case. The demand effect on total output dominates for more than five years. After that time, the effects from improved allocation in the no subsidy alternative begins to generate substantially higher total output. The employment differences, however, are quite small and of short duration especially if firms expect the subsidy to be only temporary. With general lowering of the payroll tax, labour released from closed down firms is rapidly rehired in growing firms. The experiments suggest that subsidies tend to hold back this growth in other firms. (These results are preliminary and should be regarded as merely suggestive of the time dimension involved.) See further, Carlsson, Bergholm and Lindberg, *op. cit.*

24. See 'Statsföretag privatiseras: Per Sköld vill sälja ut dotterbolag över börsen', *Veckans Affärer*, No. 7, 19 February 1981, p.3.

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