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Beyond Startups: Sweden's Scale-Up Challenge

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Abstract

This paper analyzes Sweden's entrepreneurial performance from an institutional and evolutionary perspective, using the concept of the collaborative innovation bloc. It argues that economic development is driven not by entrepreneurial entry per se, but by the capacity of institutional arrangements to channel entrepreneurial effort into large-scale, productivity-enhancing activities. Sweden provides an instructive case: despite strong performance in innovation and start-up formation, the economy performs less well in turning young firms into globally competitive enterprises. The analysis emphasizes the complementarity between entrepreneurs and key actors—investors, skilled employees, and competent customers—and the role of institutional incentives in coordinating their interaction over time. While past reforms have improved conditions for entry, remaining distortions in taxation, labor market regulation, and capital allocation may bias outcomes toward early exit rather than sustained growth.

JEL classification

H50, I28, L26, O31, P16, R38

Keywords

collaborative innovation bloc, entrepreneurial ecosystem, entrepreneurship policy, scale-up policy, innovative entrepreneurship

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1. Introduction

A small share of firms accounts for a disproportionate share of output and employment growth. This has led researchers and policymakers to focus increasingly on high-impact entrepreneurship: entrepreneurial activity that generates substantial economic effects. This is sometimes referred to as high-impact entrepreneurship (Acs 2008; Henrekson and Johansson 2010). There is a strong positive correlation between the level of high-impact entrepreneurship and the income level in a country, while the proportion of self-employed people is highest in poor countries.

Innovation and entrepreneurship are essential drivers of prosperity, but on their own they are not enough. The greatest social value often arises during the scale-up phase, when entrepreneurs, investors, and key employees jointly develop and expand an innovation until it reaches its full potential.

Scaling enables firms to achieve economies of scale in production and distribution, reducing unit costs and lowering prices. As prices fall, a growing share of the total value created shifts to customers in the form of consumer surplus. In other words, the price consumers actually pay becomes progressively smaller relative to the maximum amount they would have been willing to pay, increasing overall welfare.

An economy may generate substantial new knowledge that fuels innovation and entrepreneurship, leading to the creation of promising new firms. However, these firms may be sold at an early stage, with large-scale expansion and commercialization taking place abroad.

This outcome can arise for several reasons. There may be a shortage of skilled labor needed to support the next phase of growth, or founders may perceive the risks associated with scaling as too high. Access to growth capital may be limited, constraining expansion opportunities. In addition, tax structures or regulatory frameworks may create incentives for early exit rather than long-term development. In such cases, while the economy succeeds in generating ideas and startups, it captures only a limited portion of the value created during the critical scaling phase. The uncaptured value consists not only of the direct domestic value that would have been created by the scaleup itself; acquisitions may also transfer valuable know-how abroad and reduce the long-term domestic benefits associated with headquarters functions, employment, taxation, and managerial capabilities.[1]

For a long time, Sweden suffered not only from a lack of new firms but also from a lack of firms that grew large. Many observers would say that the period from the early 1950s to at least the mid-1980s can be characterized as an ice age for Swedish entrepreneurship and

[1] Daniely (2020) argues that the same is true in Israel. He points to an "exit culture" where entrepreneurs and investors often aim to sell to a larger multinational rather than build independent global corporations. Avnimelech and Amit (2024) identify a partial institutional response to the scale-up problem, namely that small firms shift toward more collaboration with global firms to get access to complementary assets, global distribution, procurement channels, and corporate customers.

business (Henrekson, 1996). All new net employment was generated in the public sector, and the private sector was dominated by a limited number of large firms. Now the situation is very different, with many new firms and a vibrant stock market.

There is little doubt that the conditions for innovation and entrepreneurship have improved markedly over the past 35 years. The ecosystem is more mature, access to capital has improved, and support structures for startups are far stronger than they once were. The more pressing issue, however, is whether these conditions are sufficient for innovative firms to realize their full potential. Are promising firms able to scale domestically, or are they constrained at an early stage? Are scalable ventures being sold prematurely, before they have had the opportunity to grow into globally competitive firms?

Ultimately, the key question is whether the value created during firm expansion will accrue to Sweden. If this process occurs domestically, the benefits are likely to extend well beyond founders and early investors, generating employment, tax revenues, and productivity gains that are broadly distributed across Swedish society. If not, a significant share of the long-term economic and social value may be realized elsewhere. The central issue is therefore not whether Sweden can generate startups, but whether it can support the transformation of promising startups into independent, globally competitive scale-up firms.

The purpose of this essay is to examine the strengths and weaknesses of Sweden's institutional framework for entrepreneurship and firm growth. Particular attention is given to identifying the elements that may constrain the scaling of innovation-based and entrepreneur-driven firms. By highlighting areas in need of reform or reinforcement, the essay seeks to clarify how the framework can be strengthened to better support the expansion of Swedish firms and enable them to reach their full potential.

2. The empirical picture

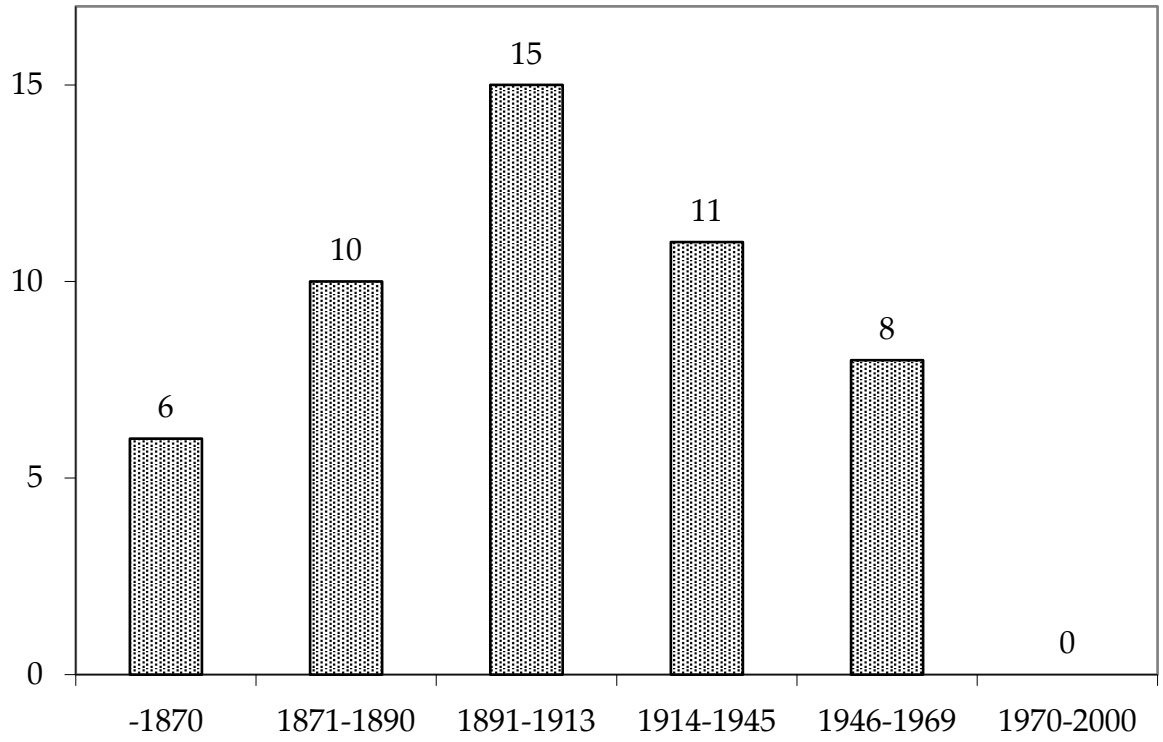
Between 1950 and 1993, Sweden's population grew by 1.5 million people, while total employment increased by approximately one million. Strikingly, more than 100 percent of these net new jobs were created in the public sector, which expanded by 1.1 million positions. Over the same period, private-sector employment declined by around 100,000 jobs (Bjuggren and Johansson 2009).

The weakness of private-sector job creation was mirrored in other indicators of entrepreneurial dynamism: low rates of new firm formation, few stock market listings, and an almost complete absence of newly founded firms growing into large enterprises (Agnblad et al. 2001; Davis and Henrekson 1997). This pattern is underscored by *Figure 1*, which shows that none of Sweden's 50 largest firms by turnover in 2000 had been founded after 1970.

Following the severe economic crisis of the early 1990s—during which Sweden experienced three consecutive years of negative growth and the loss of 14 percent of all jobs (with the employment rate among 16–64-year-olds falling from 83.4 to 71.9 percent in just four years)—the trajectory shifted markedly. GDP per capita began to grow rapidly, and real wage

development underwent a structural break. After two decades of near stagnation up to 1995, real wages rose by more than 60 percent over the subsequent twenty years, signaling a significant improvement in economic performance and living standards (Ekonomifakta 2026a).

Figure 1 Date of establishment for Sweden's 50 largest companies by turnover in the year 2000

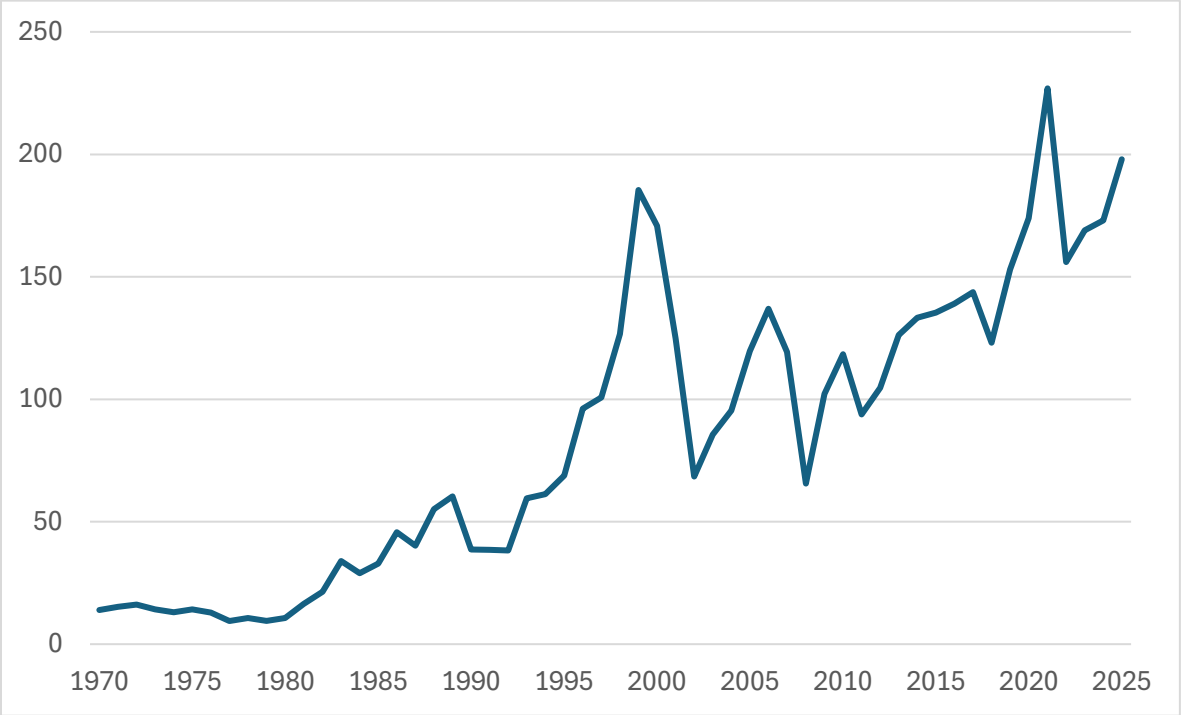


Source: NUTEK and ALMI (2001).

This reversal was preceded by a revival of Swedish capital markets. Until the early 1980s, the Swedish stock market was almost completely frozen. New issues or IPOs were rare and, as shown in *Figure 2,* the total market capitalization as a percentage of GDP was less than 10 percent. This then changed dramatically, and in the 2000s, the total value of the Stockholm Stock Exchange (now Nasdaq Stockholm) has, with few exceptions, been more than 100 percent of GDP and has averaged 140 percent of GDP.

On April 21, 2026, there were 987 Swedish firms listed on a public trading venue for company shares. In addition to the regular Stockholm Stock Exchange, Nasdaq Stockholm, with approximately 360 listed firms, there are several other trading venues such as First North, Nordic SME, Spotlight, and Xterna. Typically, these firms have one or two main owners, often but not necessarily the founders, with a sufficiently large shareholding to effectively control the firm. The total market value of all shares listed on Nasdaq Stockholm amounted to roughly SEK 12,000 billion, which corresponded to 183 percent of Sweden's GDP.

Figure 2 The total value of listed shares on the Stockholm Stock Exchange (Nasdaq Stockholm) as a percentage of Sweden's GDP, 1970–2025 (%).



Note: Total market capitalization is measured at the end of each year.
Source: Stockholm Stock Exchange annual reports (1970–1987), Riksbank annual reports (1988–1999) and Nasdaq Stockholm (2000–2026).

Over the past decade, Sweden has exhibited a striking economic paradox. On the one hand, the country performs exceptionally well on several indicators of corporate strength and innovation. Swedish corporations are five times more prevalent among Europe's top 1,000 listed firms than would be expected given the country's population size. Swedish firms also invest more in research and development relative to GDP than their counterparts in both the United States and the European Union. In addition, Sweden produces more unicorns (startups valued at over USD 1 billion) per capita than any other country in Europe, and more than one-third of all European decacorns (firms valued above USD 10 billion) were founded in Sweden.

On the other hand, a substantial share of this value creation does not remain in the domestic economy. More than 70 percent of Sweden's unicorns eventually leave the country, typically through acquisitions by foreign firms or listings on foreign stock exchanges (McKinsey & Company 2025). This pattern points to structural challenges in scaling firms domestically and retaining the long-term economic benefits of innovation.[2]

These strengths in innovation and firm creation have not translated into strong macroeconomic outcomes. Over the past ten years, GDP per capita growth has been weak—

[2] For further evidence that the Swedish business sector suffers from a scale-up problem, see Growth Analysis (2024) and Business Sweden (2024).

just over half a percent per year—and the employment rate has remained well below its previous peak, failing to exceed 80 percent for an extended period. This is mirrored in persistently high unemployment, which has hovered around eight percent for roughly two decades (Ekonomifakta 2026b). In late spring 2026, there are few indications of a near-term improvement in either growth or labor market performance.

Sweden therefore faces two interrelated challenges: weak long-term growth, reflected in subdued real wage increases, and insufficient job creation. Addressing these issues will require policies that strengthen the fundamental drivers of entrepreneurship while also enabling firms to scale and remain anchored in the domestic economy. Sustainable improvements in prosperity and employment depend on an institutional environment that allows innovative firms not only to emerge, but also to expand and realize economies of scale.

The remainder of this essay examines the most important "rules of the game" (Douglass North 1990) that shape "the reward structure in the economy" (William Baumol 1990). Its purpose is to assess which aspects of the current framework function well and to identify areas where significant reform is needed to foster stronger entrepreneurship, more robust firm growth, and broader value creation.

3. Entrepreneurship and the collaborative innovation bloc

Entrepreneurship scholars have long recognized that entrepreneurial ventures do not emerge in isolation. For example, the Swedish research tradition labeled the experimentally organized economy (EOE; see, e.g., Eliasson 1996, 2000, and Johansson 2009 for a synthesis) recognizes that the entrepreneurial process is inherently collaborative: to pursue their innovative projects, entrepreneurs need to cooperate with several actors whose complementary skills and resources drastically increase the probability that an innovation-based venture will be successful. These complementary actors supply capital, technical knowledge, managerial expertise, market access, and feedback from users and customers. This perspective is useful for understanding how innovations come about in a modern economy and how the institutional underpinnings of that economy ought to change to achieve more innovation and prosperity.[3]

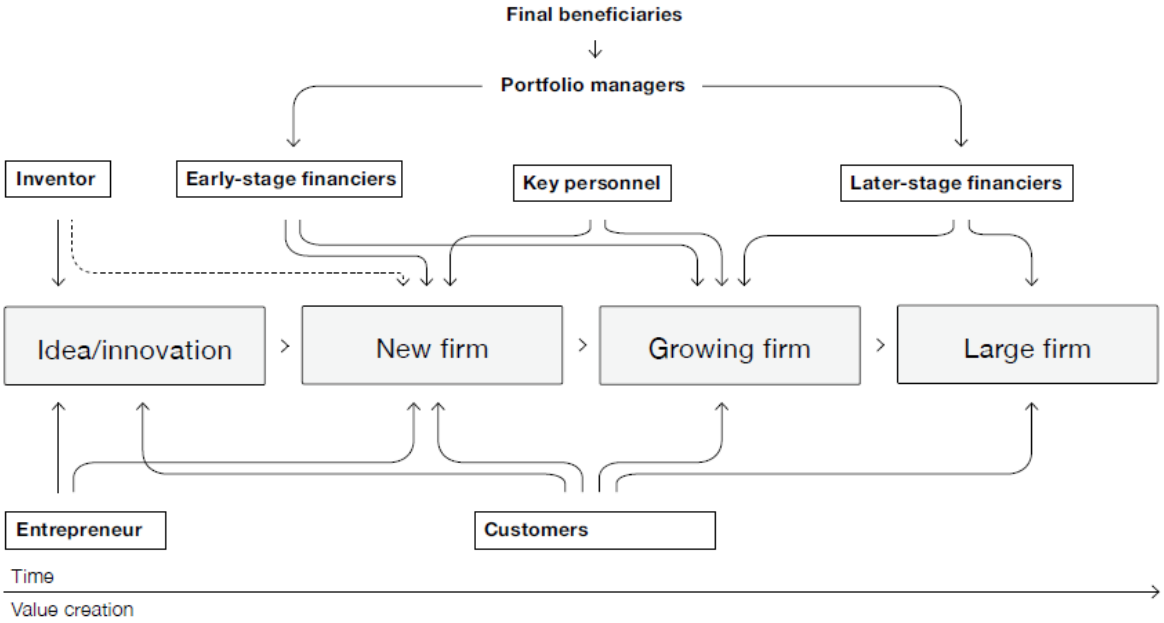
It is not entrepreneurial activity per se that drives prosperity, but socially productive entrepreneurship—channeled into firms with strong growth potential. The key is not simply the number of new ventures, but their capacity to create value, innovation, and scale. However, as already noted, entrepreneurs do not operate in isolation. To transform ideas into

[3] The EOE perspective shares many features with the more recent literature on entrepreneurial ecosystems (Wurth et al. 2023; O'Connor et al. 2018) and the national system of entrepreneurship approach (Acs et al. 2014), but its roots can be traced back to the works of Swedish economists Johan Åkerman and Erik Dahmén; see Erixon (2011) and Dahmén (1970). While these other perspectives offer valuable insights, they seldom make a clear distinction between actors and institutions, and "the institutional variables that are used, such as technology absorption, gender equality, R&D spending, and depth of capital markets, are not institutional variables; they are outcomes resulting from the evolution of the economic system in a given institutional setup" (Braunerhjelm and Henrekson 2016, p. 101).

viable and growing businesses, they must assemble and coordinate a wide range of competencies and resources held by others—capital from investors, expertise from skilled employees, knowledge from research institutions, and access to markets through customers and partners. In this sense, the entrepreneur is best understood as the hub of an extensive collaborative network, orchestrating the contributions of many actors to bring an innovation to fruition and expand it successfully.

In my research with Niklas Elert, Dan Johansson, and Mikael Stenkula, we argue that collaboration between entrepreneurs and holders of other requisite competencies takes place within what we call the *collaborative innovation bloc*: an ecosystem comprising several pools of actors with complementary skills and resources.[4] In addition to the entrepreneur, we identify at least five other competencies required for innovation-based entrepreneurship: inventors, key employees, competent customers, and early- and later-stage financiers. Their relationships are illustrated in *Figure 3*. Their skills and resources are needed to varying degrees at different stages of entrepreneurial projects. If any are absent at a critical moment, the likelihood that a project will reach industrial scale is significantly reduced.

Figure 3 The collaborative innovation bloc: an overview.



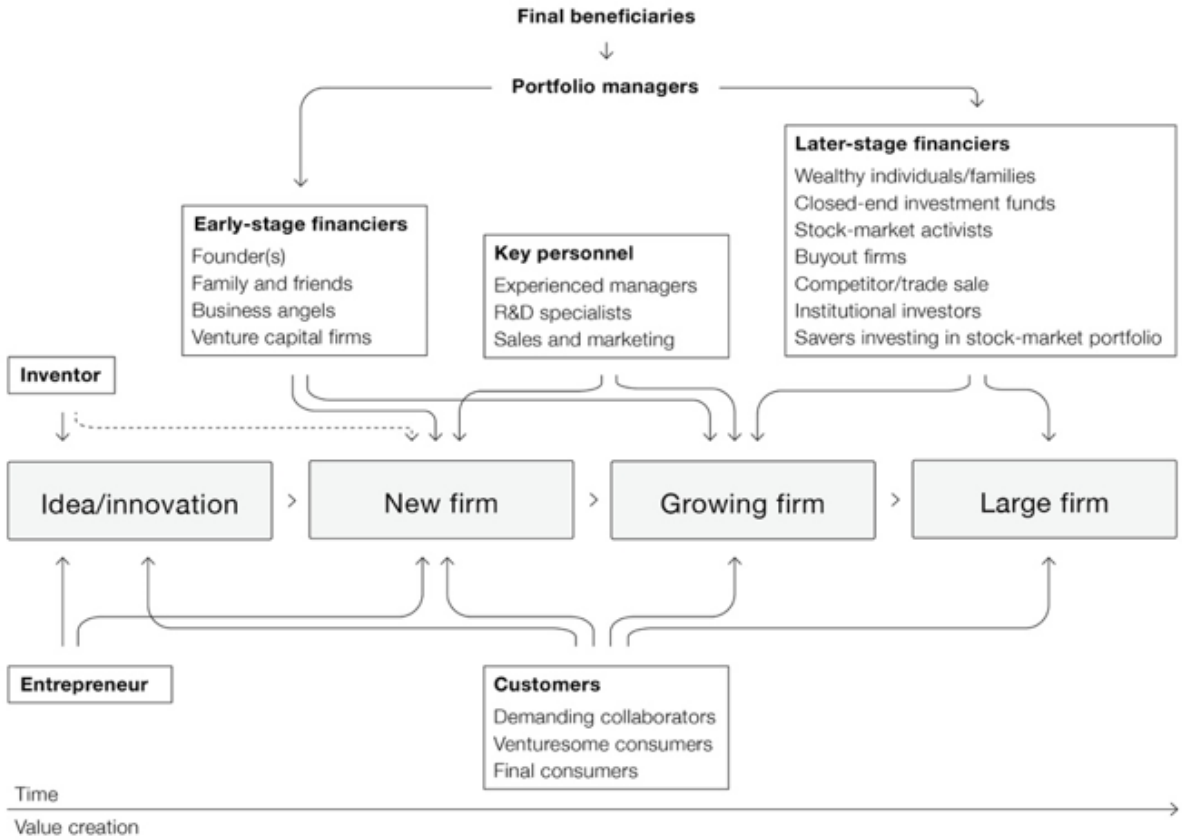
Source: Elert and Henrekson (2021).

Figure 4 presents a more detailed version of the collaborative innovation bloc. It shows the important interaction between the final beneficiaries and the various categories of financiers in the early and later stages. The figure also identifies the most important types of key individuals and customers.

[4] A closely related concept is technological innovation systems (Carlsson and Stankiewicz 1991).

The early commercialization phase mainly involves entrepreneurs (and possibly also inventors) and, to a lesser extent, other types of skilled labor. In the scale-up phase, experienced managers, salespeople, and R&D specialists are activated. Founders, family and friends, business angels, and venture capital firms finance development in the early stages, while later-stage financiers only enter the picture when the firm is ready to scale up significantly. This figure is, of course, a simplification—for example, experienced managers and financiers in later stages may be involved much earlier, and different actors may work in parallel, overlap, or replace each other in different phases. The same person may sometimes fill more than one role, e.g., both as an entrepreneur and as a manager when the firm reaches a more mature stage.

Figure 4 The collaborative innovation bloc: a detailed overview.



Source: Elert and Henrekson (2021).

Later-stage financiers can potentially belong to a number of different categories: wealthy individuals/families, closed-end investment funds, stock market activists, institutional investors (pension funds, mutual funds), buyout firms, stock-picking individual savers, and competitors who want to take over the firm's operations through a trade sale. Later-stage financiers have similar skills and functions to venture capitalists in terms of financing and transferring knowledge and skills, but at a later stage when founders and early-stage financiers want to realize their investments. These agents therefore evaluate the firm's potential and assess whether it would be advantageous to take control of the firm and replace

the entrepreneur and management team. An important distinction among later-stage financiers is between those who are active owners and passive investors, such as pension funds, mutual funds, and stock-picking individuals.

A trade sale—selling the firm to another firm, usually in the same industry—is arguably the most common way of exiting. In this case, the buyer gains full control of the firm, and the entrepreneur/founder leaves the firm (usually with significant financial assets). These assets make it possible to start new firms or act as a business angel or venture capitalist. A trade sale is often due to a lack of crucial expertise in the firm, which makes it impossible to scale up the business on its own.

Customers are the ones who ultimately determine whether an innovation will be successful; they make the final selection. The willingness and ability of individual customers to dare to buy and use new products effectively, as well as the openness of intermediate producers to new knowledge and new products, can be decisive drivers of innovation. The contribution of competent, engaged, and demanding customers is often crucial to the development of innovative products. Particularly in the early stages, they act as demanding partners and serve as valuable sources of information about user needs and preferences, provided they are representative of a broader customer base. Sometimes they even act as strategic partners who take an active part in the development and commercialization of products and thus have a decisive influence on the development and design of new products.

For an innovation/business idea to have a high probability of reaching its full potential, the collaborative innovation bloc must be sufficiently large and deep to achieve critical mass, i.e., there must be sufficiently large pools of each skill to recruit from so that each function in the collaborative innovation bloc can be filled. A lack of necessary skills or an important actor category can significantly hinder or even prevent collaborations from coming about at all.[5] But when all skills and requisite institutional arrangements are at hand at the micro (firm), meso (sector), and macro levels experimentation and entrepreneurship will be fostered and encoded in the emerging culture (Carlsson 2025).

Part of what it means to be an entrepreneur is therefore being able to productively combine different skills and resources. Politically determined laws and regulations have a fundamental impact on how the various actor categories interact, how strong their incentives are to acquire and use skills, and, ultimately, the quality of the collaborative projects. Government agencies and publicly owned companies can also be significant customers or financiers in a collaborative innovation bloc, such as those that characterize government-funded social services (Le Grand 2009; Blix and Jordahl 2021) or the procurement of military equipment (Eliasson 2010; Braunerhjelm et al. 2025), but they exert influence rather than control.

[5] Although the United States is the global benchmark for both start-up and scale-up activity, there are large cross-state differences (Kim et al. 2024; Chen and Ewens 2025). Despite exceptional scale-up institutions nationally, they are spatially concentrated. If a state is falling short on crucial parts of the collaborative innovation bloc, promising firms may relocate to stronger ecosystems.

4. The Swedish rules of the game

All economies are governed by a set of institutions and rules that shape the behavior of economic actors. The effects of these "rules of the game" can create situations in which what is individually rational is not socially optimal. For example, high taxes on labor may make it more profitable for a brain surgeon to spend time repainting their house rather than providing urgently needed medical services. A wide range of such rules influences both the level and the direction of entrepreneurial activity in society (Baumol 1990). The discussion cannot cover all relevant Swedish institutions in detail. Instead, it focuses on those most pertinent to the purpose of this essay.

4.1 The rule of law and the protection of property rights

The rule of law—*de facto*, not just *de jure*—is fundamental in this context. The rule of law means that everyone enjoys equal protection under the law and that governments do not exercise power arbitrarily but ensure that fundamental political and civil rights and freedoms are protected and upheld. It also means that the state treats its citizens equally and impartially and that independent courts guarantee that the law is upheld and that violations are punished.

If property rights are strongly protected, investors can expect to retain the profits they expect from entrepreneurial activities. If legal certainty is high and the legal system is credible, it becomes much safer for entrepreneurs and complementary agents to engage in long-term, uncertain projects. Similarly, the risks are lower when entering into agreements and conducting transactions with other parties. In a society governed by the rule of law with well-defined property rights, there is greater scope for a more extensive division of labor and specialization.

Under such circumstances, entrepreneurs have favorable opportunities to exploit their ideas by entering into agreements and gaining access to external equity capital and other necessary expertise and resources in the collaborative innovation bloc.

Sweden, like the other Nordic countries, has long ranked near the top globally in terms of rule of law, low levels of corruption, and public order and safety. In recent years, however, there have been signs that the situation is deteriorating (e.g., Ring and Wallin 2025). Sweden's corruption index in Transparency International's annual survey has fallen sharply from an all-time high of 95 points in 1998 to a record low of 80 points in 2025 (Transparency International 2025). The state's monopoly on the legitimate use of force has become more difficult to maintain in parts of society, the extent of organized crime has substantially increased, and firms are being forced to devote more and more resources to security and surveillance (Mondani and Rostami 2023). Overall, these developments raise the transaction costs of entrepreneurial activity and make firm expansion more difficult.

4.2 Taxation of entrepreneurial income

Entrepreneurship combines a business idea, human capital, sustained effort, and reinvested capital over the many years required for a firm to grow and secure a strong market position. It

thus represents an *indivisible bundle* of individual inputs, making it inherently difficult to disentangle and tax the resulting returns as distinct forms of compensation to capital and labor.

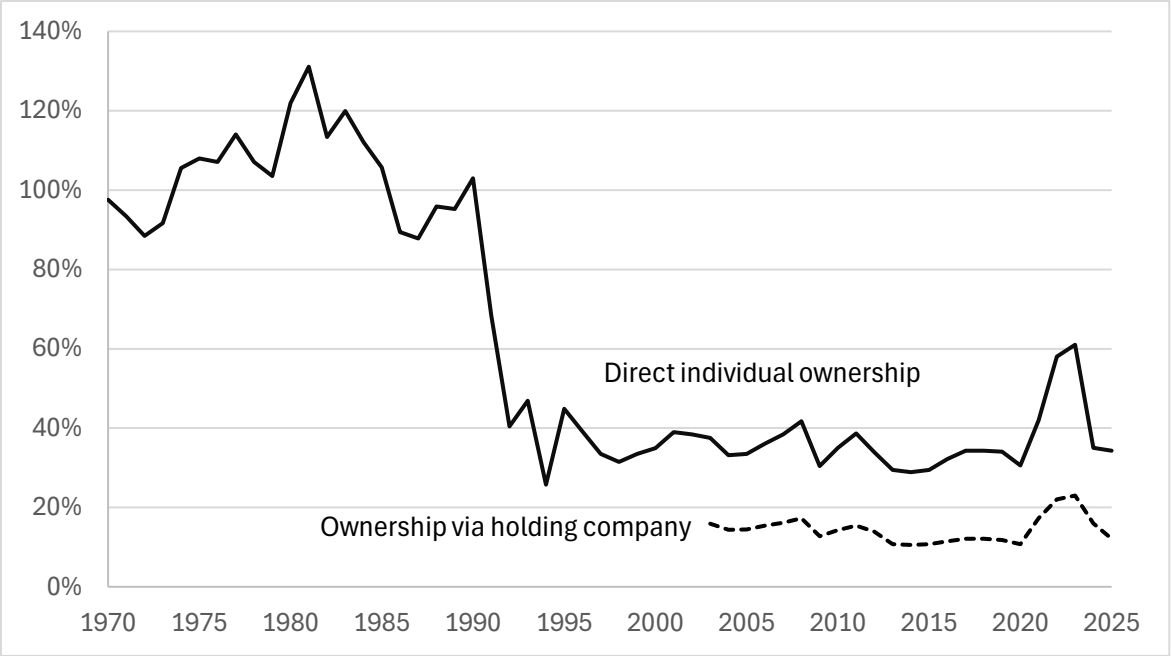
The combination of high corporate taxation, very high marginal taxes on dividends, wealth taxation based on book value, and high inflation made the real tax burden on direct individual ownership extremely high in Sweden. This is illustrated in *Figure 5*, which shows the development of the effective real marginal tax rate on an investment financed with equity capital by a natural person, where the real rate of return before all taxes is assumed to be 10 percent. During the 1970s and 1980s, the average real tax rate consistently exceeded 100 percent for such an investment.

A series of reforms has fundamentally transformed this landscape. The corporate tax rate has been reduced from approximately 55 percent to 20.7 percent in 2026; the wealth tax has been abolished; and the effective tax on dividends has fallen from levels exceeding 80 percent to between 20 and 30 percent, depending on specific circumstances (discussed further below).[6] Moreover, since 2003, capital gains and dividends on shares in unlisted firms (*näringsbetingade aktier*) are tax-exempt at the corporate level. As a result, entrepreneurs—who now typically own their operating firms through a holding company—can reinvest retained earnings without immediate tax consequences.

These reforms have significantly strengthened incentives to accumulate wealth through wholly or partly owned firms. Over time, they have facilitated the buildup of substantial private capital holdings, which in turn have become an important source of venture capital, particularly in the early stages of entrepreneur-driven ventures.

[6] See Du Rietz et al. (2015a) and Wykman (2026) for further details.

Figure 5 Effective real marginal tax rate for direct ownership by individuals (1970–2025) and for ownership through wholly owned holding companies (2003–2025).



Note: 60 percent of the return is assumed to be in the form of capital gains and 40 percent in the form of dividends. Actual inflation rates were used in the calculation.

Source: Braunerhjelm and Henrekson (2024, p. 47) plus updates by the author.

Following this description of the development of taxation of Swedish entrepreneurs, we can now evaluate taxation at the owner level for the various categories of financiers identified in *Figure 4*. All early-stage financiers—founders, family and friends, business angels, and venture capital firms—can now invest through holding companies that do not pay any dividend or capital gains tax. If the shares are owned directly, the tax rate is limited to either 20 or 25 percent. Tax exemption applies to all stock holdings in unlisted incorporated firms irrespective of ownership share, and to holdings of stock in listed firms as long as the holding company owns shares representing at least 10 percent of the votes or 10 percent of the equity.

As regards later-stage financiers, the favorable tax rules mean that there will be many more individuals/families who become sufficiently wealthy to assume the role of active owners of larger firms. Similarly, the abolition of the previously burdensome taxation of closed-end investment funds (Investor, Latour, Industrivärden etc.) has greatly strengthened their capacity to take on an active ownership role in more mature firms.[7]

Partners in buyout firms can invest through holding companies, pension funds and equity funds are always tax-exempt, and individual savers who invest in a stock market portfolio can do so through an investment savings account or a capital pension account, where taxation is a small percentage of the market value and therefore not related to any dividends or capital gains.

[7] The 2003 legislation granted full tax exemption to listed closed-end investment funds for dividends and capital gains from firms where they hold at least a 10 percent voting or equity share. Before 2003 a listed closed-end investment fund had been levied a 1.5 percent annual tax on its market capitalization, unless its dividend payouts were as large as all dividends received plus the 1.5 percent tax on its market capitalization.

These tax changes have paved the way for Sweden to develop the largest private equity market in the entire EU (Næss-Schmidt et al. 2022). In addition, the earliest stages of new firms have benefited from a dramatic increase in business angels and informal investors, with Sweden even ranking ahead of the United States according to Heyman et al. (2019).

The dynamic stock market and the large and highly competent private equity sector (early-stage venture capital firms and later-stage buyout firms) contribute both to high firm valuations and ample exit opportunities, resulting in stronger incentives to engage in innovative entrepreneurship (Norbäck et al. 2016).

Although previous reforms have greatly strengthened the incentives for founders and investors to engage in and finance innovative entrepreneurship, there is still an Achilles heel: the remuneration of key personnel (R&D specialists, experienced managers, etc.) who must be recruited at an early stage when the firm's future is still highly uncertain. In addition, employees also contribute to entrepreneurial efforts.

4.3 Taxation of employee stock options

Employee stock options can be an effective way of providing strong incentives for employee intrapreneurs, as options give them the right to share in the capital gains that result from their own efforts. If such a program is well designed, it can induce the intrapreneur to behave more like an owner of the project. However, for the instrument to be effective, gains on stock options, even when the grant is linked to employment, must be taxed in the same way as gains on the sale of shares. Until recently, gains on employee stock options were treated as wage income when the option grant was linked to employment. Stock option gains were subject to both social security contributions and a marginal tax of up to 56–57 percent, resulting in a total tax burden of approximately 68 percent. In practice, this rendered the instrument unusable.

In 2018, a new instrument was introduced in Sweden: qualified employee stock options. This instrument enables firms that are less than 11 years old, have fewer than 150 employees, and have a turnover (or assets) not exceeding SEK 280 million to issue employee stock options with a vesting period of three to ten years to their employees at no cost. Any gains are then subject to capital gains tax. The system nevertheless remains limited. For example, the rules disqualify tech companies, whose value can relatively quickly exceed SEK 280 million, from issuing qualified employee stock options. Another limitation is that the system does not apply if the startup is a spin-off from an existing firm that is more than ten years old, or if the firm or holding company providing more than 50 percent of the initial financing is more than ten years old.[8]

Despite the changes, Swedish tax rules tend to encourage founders to sell the entire firm as soon as external owners enter, as this is the easiest way to take advantage of a lower tax rate on all or most of the capital gains. In that case, what has often proven to be crucial to building a

[8] For further details regarding the taxation of employee stock options in Sweden, the reader is referred to Braunerhjelm and Henrekson (2024, pp. 152–156) and StartupTools (2026).

valuable firm is lost, namely an agreement by which the entrepreneur and other key talents are given strong incentives to continue creating value precisely because they are guaranteed a future ownership stake in the firm without having to bear the entire financial risk. If the founders sell the entire firm at an early stage, the possibility of step-by-step financing and the well-known advantages that this entails also disappear. The initial investment then becomes larger because the risk and operating costs increase when the founder has left the business and key personnel demand higher salary compensation if employee stock options cannot be used.

4.4 Taxation of employee income

Taxation of labor, including statutory social security contributions, was exceptionally high in Sweden for a long time. This significantly reduced the return on individual skills development and hampered the dynamic development of large parts of the service sector.

Taxes on labor have been substantially reduced since the early 1980s, when around 70 and 88 percent of any income increase went to taxes and social security contributions for average and high-income earners, respectively (Du Rietz et al. 2015b). In 2026, full-time workers with a median income paid less than 45 percent of an income increase in taxes and social security contributions (marginal tax wedge), while those with a monthly salary of SEK 55,000 (≈ EUR 5,000) and above had a marginal tax wedge of 62–65 percent (depending on the municipal tax rate).

The tax burden therefore remains relatively high, although it has fallen substantially. Moreover, the effects of high taxes on labor have been significantly mitigated by the so-called ROT and RUT deductions for construction/renovation and household-related services, respectively. This has facilitated labor specialization and stimulated new firm formation in these sectors.[9]

4.5 Savings and financing

Unlike in the past, saving is now tax-favored in Sweden. With the tax system around 1980, an interest-bearing investment that yielded five percent in real terms before tax resulted in a return of approximately minus seven percent after tax and inflation while borrowers had a sharply negative real interest rate after deductions. Unsurprisingly, household savings were negative.

If the same investment is made today within the framework of an investment savings account or a capital pension account, no more than a single percentage point of the real return is typically lost through taxation. Thus, five percent in real terms before tax becomes at least four percent in real terms after tax. The reformed tax system combined with a sharply lower rate of inflation has made saving more attractive than before. As a result, household saving

[9] The so-called RUT rebate introduced in 2007 allows each taxpayer to buy household-related services (cleaning, childcare, gardening etc.) for up to SEK 75,000 per year and have the labor cost reduced by half by means of this tax rebate. A similar system exists for the renovation or extension of one's own home (the ROT deduction). Systems such as these soften the inhibiting effect of high labor taxes on the development of a private services sector.

rates have increased.[10] However, these favorable tax conditions only apply to investments in bank-managed funds and listed securities.

A large part of household savings consists of pension savings through employers and assets in previously tax-advantaged private pension savings (Waldenström 2024; Jansson et al. 2025). Many individuals therefore hold substantial wealth in large funds managed in ways that prevent these assets from being used as risk capital in their own businesses or those of relatives. Regulatory changes that enable the "de-institutionalization" of parts of pension savings would make significant amounts available for equity investments in entrepreneurial firms.[11]

4.6 The labor market and the social insurance system

Labor markets in all countries are characterized by a wide range of regulations governing issues such as employment protection (including the degree of job security), rules for dismissal in cases of redundancy, notification procedures, mechanisms for resolving conflicts between employers and employees, the conduct of contract negotiations and wage setting, regulations governing strikes and lockouts, and the rights and powers of union representatives. The design of these regulations affects the conditions for entrepreneurship.

The continuous process of experimentation and selection in the market means that firms are started, closed down, expanded, or downsized. Extensive restructuring in the labor market is an inevitable part of a modern economy (e.g., Haltiwanger 2022; Henrekson 2021). Since gross labor flows tend to be greater in newer, smaller, highly specialized, and fast-growing firms, regulations such as strict seniority rules for layoffs place a greater burden on such firms.[12]

Labor market regulations, especially strict seniority rules for layoffs and high costs for redundancies, reduce entrepreneurs' scope to adapt their workforce to fluctuations in demand. Furthermore, seniority rules, which are based on the "first in, last out" principle, mean that being tenured at the current employer becomes relatively more important for an individual's income security than individual skill. This increases the opportunity cost for employees to change jobs, and the opportunity cost rises over time, which reduces the recruitment opportunities for new firms. Strong employment protection therefore raises the opportunity cost of both changing jobs and becoming an entrepreneur, which reduces the propensity to try to start a high-growth firm and makes it more difficult for these firms to recruit the requisite staff.

[10] Household saving as a share of disposable income was negative during the 1980s and 1990, while it began to rise sharply in the early 2000s, consistently exceeding 10 percent since 2010 (Sveriges Riksbank 2023, Figure 53).
[11] In this context it is relevant to point to Daunfeldt et al. (2016). They find that high-growth firms initially tend to have low profits and weak financial positions, which helps explain why many fail to sustain high growth.
[12] There is also causal Swedish evidence that strict seniority rules impede job growth in small firms (Bornhäll et al. 2017).

Compared with the situation prior to the economic crisis of the early 1990s, the Swedish labor market has become more flexible. Employers now have greater scope to use probationary, fixed-term, and project-based contracts, to hire through temporary work agencies, and to apply exemptions from seniority rules in cases of redundancy. In addition, a general right to fixed-term employment for up to twelve months has been introduced.

At the same time, regulations that can be particularly burdensome for small and medium-sized enterprises, especially in the service sector, largely remain in place. Strict seniority rules and strong employment protection continue to make workforce adjustments costly and complex.

An important regulatory reform would be to reduce the disadvantages associated with changing jobs by increasing the portability of employment-related rights. Greater portability would allow labor market regulations to facilitate, rather than hinder, adjustment and mobility. It would also enable individuals to seize opportunities that require moving between employers or transitioning from paid employment to self-employment. One possible approach would be to introduce financially sustainable severance accounts that accrue during employment.

4.7 The production of tax-financed social services

Large-scale industrial production became the implicit model for the provision of welfare services (health care, education, social services). In this case, it was the public sector rather than large firms that accounted for production, which excluded private entrepreneurs from a large and growing part of the economy. The opening up of public services to competition in recent years has created a new arena for productive entrepreneurship within the framework of profit-driven firms, and the private sector's share of the production of many services has grown rapidly (Blix and Jordahl 2021). Not least, the strong effect of the free school reform in the early 1990s is evident, which has meant that 16 percent of primary school pupils and 31 percent of upper secondary school pupils attend private schools.[13]

Attempts to introduce competition in the health and social care sector were made as early as the early 1990s. By 2022, there were more than 15,000 private healthcare companies of all sizes and types of operation (Vårdföretagarna 2022). The Freedom of Choice Act (LOV 2008:962) came into force in 2009. This has led to a rapid increase in the proportion of private providers within publicly funded healthcare. Almost half of all visits to primary care doctors now take place at private healthcare providers. The proportion within specialized somatic care and specialized psychiatric care is over 25 percent. This increased openness to private providers is likely to create opportunities for new firm formation.

4.8 Human capital for entrepreneurship

The Swedish education system performs poorly in building knowledge among children and young people. Research points to growing problems in Swedish schools, including weak reading comprehension, poor mathematics skills, uneven teaching quality, and declining

[13] For an extensive analysis of the initiatives to marketize the production of tax-financed services, the reader is referred to Blix and Jordahl (2021).

knowledge standards. Almost one in five pupils fail to obtain passing grades in primary school, meaning they cannot progress to a national upper secondary program, and a similar proportion of those who start a national upper secondary program fail to obtain an upper secondary diploma (SOU 2025:18).

In international comparisons such as PISA and TIMSS, Sweden lags behind the leading countries. The weakest students fall behind the most, and students' socioeconomic background has a major impact on their results. Far too few students reach advanced levels in mathematics, while 35–50 percent of students do so in the leading countries. Swedish students also performed below average in PISA's creativity test (Henrekson and Wennström 2022).[14]

Weak foundations in primary and secondary education carry over into colleges and universities, making it difficult for students to absorb and engage with material at an internationally competitive level. Completion times are long, and a substantial proportion of students fail to graduate; among engineering students, the dropout rate is approximately 50 percent. Interest in science and technology is also limited, partly as a result of insufficient mathematics preparation in earlier stages of education. Consequently, the number of engineering graduates remains low (Ministry of Education and Research 2025).

Weak educational outcomes also make recruitment more difficult. Firms say that skills shortages are by far the most important reason why they are unable to recruit, and they find it particularly difficult to find engineers (Swedish Agency for Economic and Regional Growth 2023; Confederation of Swedish Enterprise 2026).

The quality of both upper secondary and higher education needs to be improved. Swedish schools need to return to an updated classical view of knowledge, characterized by teacher-led instruction, a well-structured teaching environment with clear goals, and systematic progression based on concrete course curricula. Such changes are in the pipeline in the coming years (SOU 2025:18; SOU 2025:19).

4.9 Agglomeration effects

Conditions for growth and job creation are generally more favorable in metropolitan areas than in smaller towns. The opportunities for earning a living are better, and personal income has a higher value there due to the availability of a greater range of goods and services (e.g., Moretti 2012; Moretti and Thulin 2013).

One major obstacle is rent control. The housing market needs both a well-functioning rental sector and a large owner-occupied sector. Many households are unable or unwilling to take the risks that ownership entails. Many people are also forced to use their entire creditworthiness to finance their own homes and thus lack the credit capacity to finance their own or a relative's business.

[14] See Henrekson and Wennström (2022) for further details.

The costs of the regulated system are disproportionately borne by the newcomers. In addition, poor adaptation of housing consumption to preferences has side effects on the labor market and the location of production. If it is difficult for newcomers to find housing in high-growth regions, firms' recruitment opportunities are impaired.

Because housing needs evolve over the life cycle, and because densely populated areas face persistent housing shortages, it is essential that the housing stock be used efficiently. This requires strong incentives for mobility within the existing stock. However, the current tax structure works in the opposite direction. Owner-occupied housing is lightly taxed on an ongoing basis but heavily taxed upon sale. In the very locations where mobility is most needed, moving typically triggers substantial capital gains taxation. This lock-in effect discourages households from relocating when their housing needs change, thereby reducing turnover and contributing to misallocation within the housing market.

The expansion of metropolitan areas requires improved infrastructure and expanded public transport. Investments in rail transport locally and regionally are particularly important. Policy action in this area has been insufficient. Most strikingly, although the Mälardalen and Skåne regions are particularly well suited to rail transport, there are still single tracks over long distances around Lake Mälaren, and in Skåne regional, long-distance, and freight trains have to share too few tracks. This results in track congestion. As a result, Sweden will not be able to take advantage of the opening of the Fehmarn Belt connection in 2029 and increase the share of freight transport by rail.

Another obstacle is the municipal tax equalization system, whereby a large proportion of the tax revenue of wealthier municipalities is transferred to poorer municipalities. Every year, some SEK six billion of the Stockholm Region's tax revenue is redistributed to other regions (Stockholm Region 2024). The purpose of the redistribution may be well-intentioned, namely to guarantee equal access to social services regardless of tax revenue. However, the cost of tax-financed social services rises in line with tax revenue; local costs are higher in more densely populated areas, and staff in publicly funded activities must be compensated at a level on par with the local wage level in order to be able to recruit competent personnel.

A desired increase in urbanization and thus higher innovation and growth therefore also requires that society's regulations, taxes, and planning do not block the redistribution of resources to the regions and locations with the greatest growth potential.

4.10 Direct support

Sweden has a wide range of support schemes for entrepreneurship, not least to benefit areas with low employment, specific industries, or to assist the unemployed. In recent years, there have been extensive opportunities for firms to receive support for projects that contribute to the green transition (Svensson 2024; Sandström 2026). Such schemes risk diverting entrepreneurial talent from more viable activities.

Lerner (2020) discusses common mistakes in connection with public measures that directly interfere with the entrepreneurial process: the time horizon is too short, they support firms, industries, and regions that private actors are skeptical of, and public support programs give actors the wrong incentives by reducing or completely eliminating the negative effects of failure. Although some public initiatives have, ex post, helped catalyze dynamic entrepreneurial environments, it is still not possible to conclude that direct public intervention can be expected to have a positive effect on innovation capacity and entrepreneurship.

5. Conclusions about the Swedish rules of the game

Sweden's current institutional obstacles have not produced a shortage of entrepreneurs per se. Rather, they have shaped the type of entrepreneurship that emerges and the extent to which firms grow domestically. Few companies have grown large. A review of the situation in 2000 showed that not a single one of the largest firms in Sweden in terms of turnover was founded after 1969.

In recent years, the conditions for productive entrepreneurship have improved significantly in key areas: the profitability of working has increased, taxes on entrepreneurial income have been significantly reduced, previously heavily regulated product markets have been deregulated, and new arenas for productive entrepreneurship have opened up in personal services and the welfare sector.

These reforms triggered a wave of entrepreneurship, with many new firms achieving high market valuations, although few have achieved a global position comparable to that of several Swedish firms founded before the First World War. Instead, several of these firms have been acquired by foreign firms and investors and have expanded from bases outside Sweden. Sweden has become a distinguished start-up nation, but it does not yet stand out as a leading scale-up nation. This poses a potential threat, not only to Sweden's future industrial base but also to our future welfare and prosperity. Large, growing firms are an important part of a competitive industrial environment based on heterogeneous and complementary skills.

Favorable incentives need to be created for all agents in the collaborative innovation bloc, both to ensure that people with promising business ideas and entrepreneurial talent actually start firms, and to prevent the firms that are started from being sold too early because founders perceive it as more advantageous than continuing to scale up the business. Important measures include increased opportunities for private individuals to invest part of their pension savings in unlisted shares, streamlining social security systems such that social insurance entitlements and workplace-related benefits become fully portable when changing employers or labor market status, improving the quality of Sweden's education system, which increases the supply of skilled labor, reducing regulations in the housing market, and improving infrastructure and public transportation in metropolitan areas, where growth opportunities tend to be greatest.

Sweden's challenge is not primarily to generate more entrepreneurship in general, but to ensure that more entrepreneurial effort is channeled into firms capable of sustained domestic

growth, global competitiveness, and broad-based prosperity. Even though conditions in Sweden have improved significantly since the mid-1980s, the country cannot rest on its laurels. The reform process that began in the mid-1980s stalled around 2010. To ensure continued strong prosperity in Sweden, it is crucial that it be resumed.

6. Concluding remarks

Productive entrepreneurial efforts are crucial to achieving high prosperity. However, entrepreneurship is not automatically productive. It is only when the institutional framework conditions ("the reward structure") encourage the right kind of entrepreneurship that an entrepreneur-driven prosperity-creating growth process can be initiated and sustained. The framework conditions are determined by political decisions in a wide range of areas. Put simply, institutional conditions must be favorable enough for innovations and valuable ideas to become the foundation of fast-growing firms.

Those who care about the future development of prosperity in their country cannot rely on a number of powerful entrepreneurs to step forward and provide others with well-paid jobs and high incomes. The more promising path is to improve the institutional conditions for productive entrepreneurship and for the scaling of both new and existing firms in key areas.

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He received his Ph.D. in 1990 from the University of Gothenburg with his dissertation *An Economic Analysis of Swedish Government Expenditure*. Throughout the 1990s, he conducted several projects that aimed to explain cross-country growth differences. Since the turn of the new millennium, his research has focused primarily on the economics of entrepreneurship. He has particularly studied the institutional determinants of the business climate, i.e., how key rules such as the tax system, labor market regulations, and the structure of the credit market affect factors such as industry composition, corporate structure, business growth, and the entrepreneurial start-up rate. In this area, he has published extensively in scientific journals and contributed several research surveys to *Handbooks* in the field of entrepreneurship.

In addition to his academic qualifications, Henrekson has extensive experience as a government-commissioned investigator, advisor, board member and lecturer in many different contexts, in both the business and public sectors. Since 2023 he is deeply involved in the Swedish government's reformation of the national school system.