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Comment on Anders Björklund: Income distribution in Sweden: what is the achievement of the welfare state?

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Anders Björklund provides us with a thorough overview of empirical research on Swedish income distribution in a comparative perspective. His paper contains a lot of information and some interesting results. Not all of the empirical results he surveys are very surprising, but some of them are. I have no serious objections to the main thrust of the paper, but I will bring up a few points for discussion.

Let me start by summarizing what can be regarded as Björklund's three premises regarding income distribution in Sweden:

1. Income inequalities are smaller in Sweden than in most OECD countries.
2. A secular trend toward less income inequality was reversed around 1990.
3. The tax-transfer system has contributed strongly to the low inequality of disposable income.

These three premises seem—to the extent they can be empirically substantiated—to lend support to the rationality of a cradle-to-grave welfare state of the Swedish character with centralized wage bargaining, active labor market policy, high public consumption, and a comprehensive tax-transfer system. Even if (so the argument goes) the welfare state may have adverse effects on efficiency and growth (which in itself is often disputed), such side effects can be acceptable if the primary objective is achieved: an egalitarian society with equal life chances for all.

The proponents of the traditional Swedish model can use a trend shift to higher inequality around 1990 to prove their point: Around 1990 many features of the Swedish model were changed. Centralized wage bargaining came to an end, unemployment jumped up to average European levels, capital markets were deregulated, and there was

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a dramatic change in the tax system. Even though the aggregate tax ratio remained high there was a radical reduction in the progressivity of personal income taxes, and a flat tax rate on capital income was introduced. Also, replacement rates in many transfer systems were reduced.

On the other hand, skeptics of the welfare state not only claim that it may have serious adverse effects on efficiency and growth, but they also dispute the previously listed three premises. One of their arguments is that the equality of income is a statistical delusion because it is normally based on studies of the dispersion of *annual* income. A more adequate international comparison of income dispersion may demonstrate—they argue—that the compression of annual income dispersion in Sweden may actually *increase* inequality regarding lifetime income or "life chances" in a more general sense. The Swedish welfare state primarily redistributes income over the life cycle of individuals (ESO, 1994), thereby incurring dead-weight losses on society to perform a task that is better fulfilled by private insurance and capital markets. For those who hold this view, the trend toward a more equal distribution of annual income up to around 1990 was not necessarily positive, and its reversal around that time was not necessarily a bad thing. Furthermore, this reversal may also be a statistical delusion, reflecting primarily institutional changes such as the tax reform, which led to increased realization of accumulated capital gains.

The importance of Anders Björklund´s paper can only be understood against this background. Björklund makes a serious attempt to sort out and resolve the previously mentioned issues, and to my mind he is successful in throwing some light on which side of the argument is empirically borne out by the present state of the art in this area.

As to the first objection to the premises, Björklund makes a very thorough review of the literature, and his result is quite striking. According to the literature he surveys, international comparisons of income inequality are quite robust to extensions of the time period over which income is measured. Obviously, income measured over longer time spans is more equally distributed than annual income in all countries, due to individual mobility between income groups over time. But Björklund finds no sign of *higher* income mobility in countries with higher annual inequalities. So the ranking between countries (and roughly the proportional difference in Gini coefficients between them) remains the same, independent of the time period over which income is measured.

The implication of this result is that, if you start at the bottom of the income distribution, you are not more likely to rise to higher deciles in the U.S. than in Sweden. Therefore, the distribution of annual income seems, after all, to be a reasonably good indicator of income inequalities in international comparisons, even though it exaggerates, of course, the absolute magnitude of differentials in lifetime income. To establish this result one could have hoped for income measures closer to true lifetime income than the 11 years that is the longest period in Björklund's survey. But his result looks quite robust and, pending further empirical evidence, it seems that we should accept his proposition that countries with a relatively equal distribution of annual income also rank high with respect to lifetime income equality.

Björklund's contention that annual-income differentials are a good measure of the distribution of welfare in society is further strengthened by his interesting finding that inter-temporal income variability is *higher* for low-income than for high-income groups. (This result is established by letting income over a time span of 18 years determine to which income group individuals belong.) Most of us are prejudiced to believe that inter-temporal income variability is highest in the upper income groups, due, for example, to study years, capital gains, or career changes. Björklund does find that the highest quartile has higher income variability than the middle quartiles. But his important finding is that the lowest quartile has substantially higher inter-temporal income variability than any of the other groups. Unemployment must play an important role here: While unemployment in Sweden was only 2.2% in 1985, almost 15% of the labor force had unemployment experiences from the past five years, and the incidence of unemployment experiences was twice as high for blue-collar as for white-collar workers (Söderström, 1993).

Because individuals at the bottom end of the income distribution can be expected to have less access to personal savings, to credit markets, and to financial assistance from family and friends, this finding has an important policy implication. Temporary shortfalls in factor income can have serious long-term consequences for low-income individuals or families, and therefore inter-temporal income variability at this end of the income distribution may be a matter for public policy. Björklund finds that the Swedish tax-transfer system has the desired effects: a substantial reduction of disposable income variability for the lowest quartile with much smaller effects for higher income groups.

It would be interesting to see the study by Björklund and Palme (1997) reproduced on international data sets. It seems to me that high income variability at the lower end of the income distribution is a case for public concern, and it seems that tax-transfer schemes that reduce inter-temporal variability without (possibly) strong effects on the individual's average income over longer time periods can also be defended on efficiency grounds, because they would not distort incentives for education, work, saving, and so on.

Does all this imply that the traditional Swedish welfare state has been successful in reaching its distributional objectives and that the reforms undertaken around 1990 may put previous successes at risk? In my opinion, Björklund should have been much more careful in warning his readers against jumping to such a conclusion.

First, we do not know what the distributional objectives of the welfare state are. For someone, such as the present discussant, who tried to survey the literature on "economic justice" or "fairness" more than 20 years ago (Söderström, 1977), it is striking how little progress seems to have been made since then in rendering reasonable fairness criteria operational. What we do know is that an equal distribution of income is not normally regarded as fair. Björklund makes a valiant attempt to adjust for differences in working hours, and finds that some of the reduction in annual-income inequality may have come at the expense of equal pay for equal working time. But there are no similar attempts reported to adjust for other differences, such as work effort, working conditions, investment in education, or savings patterns. We normally do not regard it as fair that that a highly educated expert working a night shift under risky conditions on an oil rig should have the same income as a service person at a gas station. Also, a lower Gini coefficient does not readily translate into a *better* distribution of income even for observers with highly egalitarian values. As previously discussed, most of us would attach higher significance to a reduction of income inequalities at the bottom end of the income distribution than to a redistribution of income from, say, the eighth to the sixth decile.

Second, Björklund does not discuss at what social cost the redistributional effects of the tax-transfer system are achieved. High tax wedges and generous benefit systems distort individual incentives, thereby reducing investment in education, work effort, risk avoidance, and, in general, the division of labor in society. They also create well-known problems of cheating and moral hazard. It is still open to scientific dispute to what extent Sweden's decline from third to eighteenth rank in terms of GDP per capita among OECD countries can be attributed to the disincentive effects of the welfare state. But for anyone interested in the level of welfare of certain social groups—not only relative to other groups in the same country but also relative to similar groups in other countries—the trade-off between equity and efficiency must be dealt with explicitly.

Finally, and perhaps most importantly, it is misleading to interpret the difference between the distribution of factor income and the distribution of disposable income as the causal result of the tax-transfer system or of the welfare state in general. The achievement of the present Swedish welfare-state arrangements can only be judged as the difference between the actual level and distribution of welfare and that level and distribution, *which would have occurred* under less extensive welfare-state arrangements. If Swedes, as some observers tend to believe, are risk averse and egalitarian by nature, then of course the alternative to the welfare state is not a total absence of risk reduction and redistribution. Instead, the alternative would be similar arrangements outside the domain of government, which might include changes in individual behavior, pure market arrangements, or collectively negotiated arrangements (see, for example, Fölster, 1998).

Some economists tend to believe that in the absence of a welfare state, Swedes would invest more in education, save more, avoid more risks, take more private insurance, care more for family members, and engage more in idealistic activities and charitable giving. Those economists may be wrong. But we had better try to make sure that they are before we attribute the relatively equal distribution of income in Sweden to the achievements of the welfare state.

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