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Is the Swedish Welfare State A Free Lunch?

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A COMMENT ON: PETER H. LINDERT. 2004. *GROWING PUBLIC: SOCIAL SPENDING AND ECONOMIC GROWTH SINCE THE EIGHTEENTH CENTURY*. CAMBRIDGE UNIVERSITY PRESS.

[Abstract](#)

WITH HIGH TAXES, HIGH PUBLIC EXPENDITURES, AND A SOCIAL policy many would call progressive, Sweden is a special country for social scientists. Peter H. Lindert makes special use of Sweden in his book *Growing Public*, first published by Cambridge University Press in 2004 and translated into Swedish in 2005.¹

The main part of the book aims to describe and explain the expansion of western welfare states.² Lindert uses Sweden to explain why the welfare state appears to be a free lunch, what he calls the “Free-Lunch Puzzle.” I argue that Lindert misrepresents Sweden when it comes to work incentives for the poor, employment of women, and employment of the elderly, and that he does not pay sufficient attention to the many reforms undertaken in Sweden since the late 1980s.

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¹ Lindert (2004), Lindert (2005).

² For comments and critique of this part, see for example Margo (2004).

THE SO-CALLED FREE-LUNCH PUZZLE

The book's marketing material and an earlier working paper (Lindert 2003) suggested that welfare states have been a free lunch. The free-lunch puzzle, however, refers to a less controversial statement: Lindert has not been able to find a robust and statistically significant negative effect of "social transfers" on economic growth. Lindert's definition of social transfers is very specific. It includes only the following (Lindert 2004, 6-7):

- Poverty relief ("welfare" in America)
- Unemployment compensation
- Non-contributory pensions
- Public health expenditures
- Housing subsidies

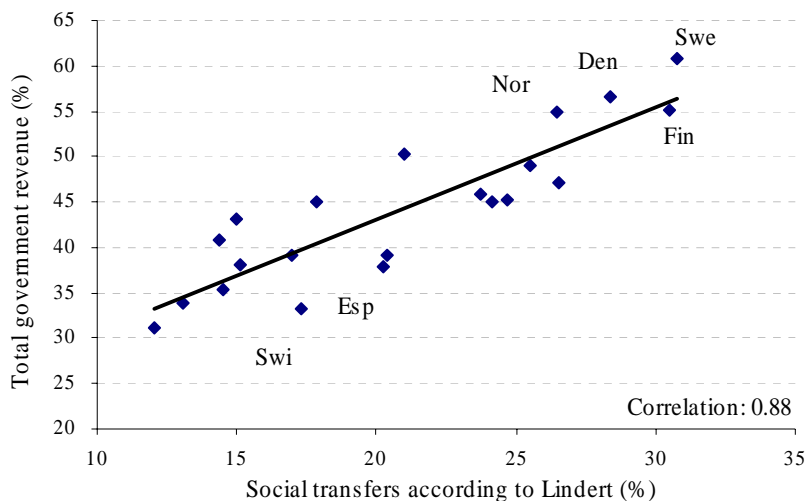
More details are provided by the datasets available at the publisher's website ([Link](#)). Public health expenditures include sickness benefits. Housing subsidies do not include public housing. Unemployment compensation does not include the costs of labor market programs. Public subsidies to corporations are not included.

Lindert acknowledges that other studies find a negative effect of different measures of government size on growth.³ In fact, Lindert stresses that these other studies typically use total taxes or expenditures as a share of GDP rather than social transfers as defined by Lindert.

Using Lindert's data, it is easy to examine the correlation between Lindert's social transfers and public expenditure as defined by the OECD. For the countries used in Lindert's study, the correlation was 0.82 for the year 1995. The correlation between social transfers and total tax revenue was 0.88 (shown in Figure 1). Compared to using measures based on total taxes or total expenditures, using the measure of social transfers chosen by Lindert makes Sweden look slightly less extreme.

³ For example Persson and Tabellini (1994), Commander et al. (1997), and Fölster and Henrekson (1999).

Figure 1: The correlation between Lindert's social transfers and OECD's total government revenue (percent of GDP, 1995)



Source: Lindert (2004) and OECD.

I refrain from delving into the econometric evidence of the free-lunch puzzle because it has long been known that it is hard to produce robust results regarding the effect of government size on growth⁴, and my theoretical explanation of this is no other than Lindert's: Tax funded government activities include many things, some of which are probably bad for growth, whereas others are more likely to have a positive effect. Another possible explanation is that growth and big government are correlated because they are both at least partially the result of other omitted variables, such as certain socio-political traditions.

For this reason, the term "Free-lunch puzzle" is highly inappropriate: The murkiness of the relationship between "social transfers" and economic growth is not a puzzle, and the welfare state is not a free lunch. Lindert's regressions seem to leave open the possibility of constructing a welfare state in a way that does not harm growth. But Lindert makes the specific

⁴ For example, Fölster and Henrekson (1999) and Agell et al. (1999) obtain different results using the same datasets. The debate has continued—see Fölster and Henrekson (2006) and Agell et al. (2006). See also Gordon and Wang (2004).

assertion that Sweden has enjoyed its welfare state for “free” (that is, with no diminution of economic growth). In developing the example of Sweden to illustrate his vision, Lindert makes faulty descriptions of the Swedish experience, both in terms of policies and outcomes. A more accurate description of Sweden suggests that Sweden’s welfare state is associated with substantial costs.

CORRECTING THE DESCRIPTION OF SWEDEN

Lindert paints a somewhat naïve picture of Sweden, and some of his explanations of the free-lunch puzzle simply do not work in the case of Sweden.

Work incentives for the poor in Sweden

In the chapter “Keys to the Free-Lunch Puzzle”, Lindert opens with a critique of means-tested social welfare. With means-testing, as income increases, benefits are reduced. Such an arrangement weakens work-incentives for the poor. Lindert claims that the means-tested policy in the United States during the Reagan years “discouraged work more than in later years or in the *true welfare states*” (230, italics added). By “the true welfare states,” Lindert probably means the welfare states usually labeled universal or encompassing, i.e. the Nordic welfare states.

Later in the chapter, Lindert writes that “the poor may face lower work disincentives in the welfare state” (245), and suggests that this might be one reason for the absence of a negative effect of social transfers on growth. To illustrate work incentives, he displays marginal net tax rates for a lone parent with two children in the United States and the United Kingdom, and compares these with “characteristic” Swedish rates.⁵ Finally, Lindert suggests: “at the bottom of the income spectrum . . . the universalist welfare states may well have lower marginal net tax rates than the lower-budget countries, which emphasize strict means testing” (249).

⁵ The marginal net tax rate measures the extent to which an increase in personal income is offset by taxes and reduced benefits.

For a Swedish social scientist, this suggestion is remarkable. The system used for poverty relief in Sweden (social assistance, in Swedish *socialbidrag*) is a typical example of a targeted, means-tested system, creating poverty traps because benefits are reduced crown-for-crown against work incomes. Lindert, however, makes no mention of the social assistance system. In Bergh (2004) I show that the social assistance system is indeed a prominent example of a non-universalistic sub-system in the universal welfare state of Sweden.

To be eligible for social assistance, the individual must show no assets. The benefit is paid in cash. One part consists of general cash benefits, given to cover expenditures on food, shoes, clothes, leisure activities, phone, newspaper and TV. For 2006, the amount of the general benefit is 3420 SEK per month (approx. US \$430) for a single adult with no children. Another part covers the individual's actual expenditures on housing, electricity, travel, home insurance, union membership, and fees to unemployment insurance. Also, in some cases expenditures on furniture and dental and medical care are also covered. Because rent and electricity benefits alone can easily sum to 4000 SEK for a single adult, the total benefit level is very high by international standards: In the calculations by Carone et al. (2004), a single adult is eligible for social assistance if her income is below 49 percent of the earnings of an average production worker.⁶ When the specific expenditure posts covered by social assistance is higher, for example if rent, electricity and travel costs are high, the part that is not tied to specific consumption is relatively smaller, and it is typically less than 50 percent.

In Lindert's table 10.2, labeled "Hurdles in the path out of poverty?" he reports marginal net tax rates "between 30% and 50%" for Sweden. According to Lindert, the Swedish rates shown are "the averages of those generally characteristic of a single adult student, a couple with children in day care, and an absent parent subject to child support, all in Stockholm 1991" (246). If the groups identified do receive social assistance, the numbers are wrong. More likely, the groups do not receive social assistance and the numbers are correct. In this case, however, the chosen groups are hardly suitable for Lindert's purpose, which is to compare work incentives for the poor in Sweden, the United Kingdom and the United States.

⁶ Given that the full-time earnings of an average production worker in Sweden was 230 000 SEK in 2001, this estimate seems to be a little on the high side. (1 US\$ is approximately 8 SEK)

Students and couples with children in day care are typically not poor in Sweden.

Those who are poor in Sweden typically face very low work incentives. In fact, low work incentive for the poor has been an issue on the academic and political agenda in Sweden for a long time—see for example Lindbeck (1997), Söderström et al. (1999), and Ministry of Finance (2003). Different measures of work incentives that include effects of benefit reductions are also a central part of the EU’s Lisbon strategy, and are closely monitored by governments.

Table 1 below shows data from 2001 in the Swedish employment strategy. The numbers indicate the income-gain portion that is offset by taxes and reduced benefits for an individual moving from being unemployed to employment (and hence losing some or all social assistance). The columns show four cases: when the person earns a third, half, two thirds and 100 percent of what an average production worker earns. We see that the marginal net tax rates are very high for people with low wages and no income-related unemployment benefit.

**Table 1:
Marginal net tax rate for an individual moving from being unemployed and receiving social assistance to employment (and hence losing some or all social assistance)**

	Wage, percent of APW ⁷			
	33	50	67	100
Marginal net tax rates of person with income-related unemployment benefit	59	86	87	85
Marginal net tax rates of person without income-related unemployment benefit	100	98	82	67

Source: [Link](#).

It should be noted that the weak work incentives affect a significant portion of the Swedish population. The Swedish social assistance is not a marginal phenomenon: During the nineties, the share of households that received at least some social assistance was between 8 and 11 percent every year (Socialdepartementet 2000).⁸ And although the standard measure of poverty has only five percent of the households below 50 percent of the

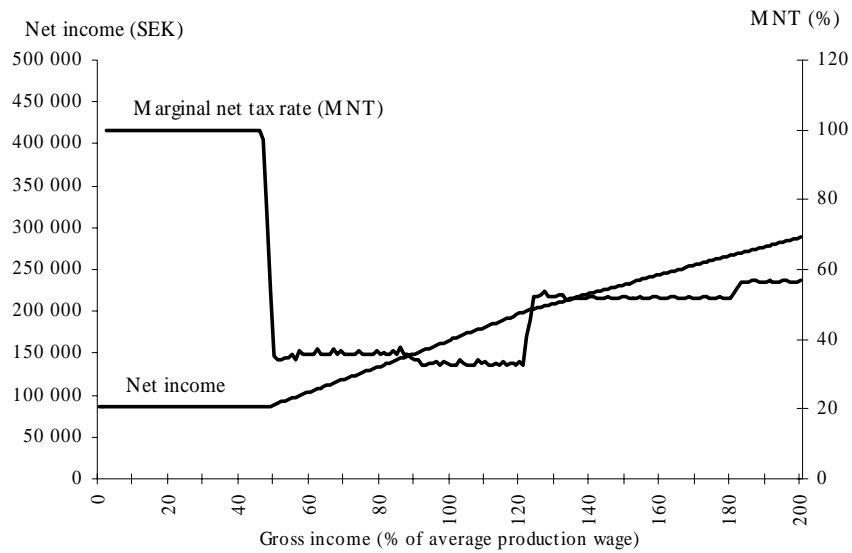
⁷ APW is the full-time earnings of an average production worker.

⁸ Among single women with children, take up rate was 29 percent in 1999.

median household income, 12 percent of the population are found below the income levels indicating eligibility for social assistance.⁹

The poverty trap in Sweden arises because social assistance is completely reduced against all individual earnings. To illustrate work incentives for different incomes, it is useful to plot net-income curves against individual gross income. Figure 2 shows the situation in 2002 in Sweden for a single person without children and not eligible for unemployment insurance. The net-income curve incorporates social assistance, other benefits, and income taxes, and hence represents the individual's budget set. When the net income curve has a slope of zero, the marginal net tax rate is 100 percent, indicating that an increase in gross income for the individual has no effect on her net income—a complete poverty trap. We see clearly that material work incentives for poor people are close to non-existent in Sweden.

Figure 2: Work incentives in Sweden in 2002 for a single person with no unemployment insurance

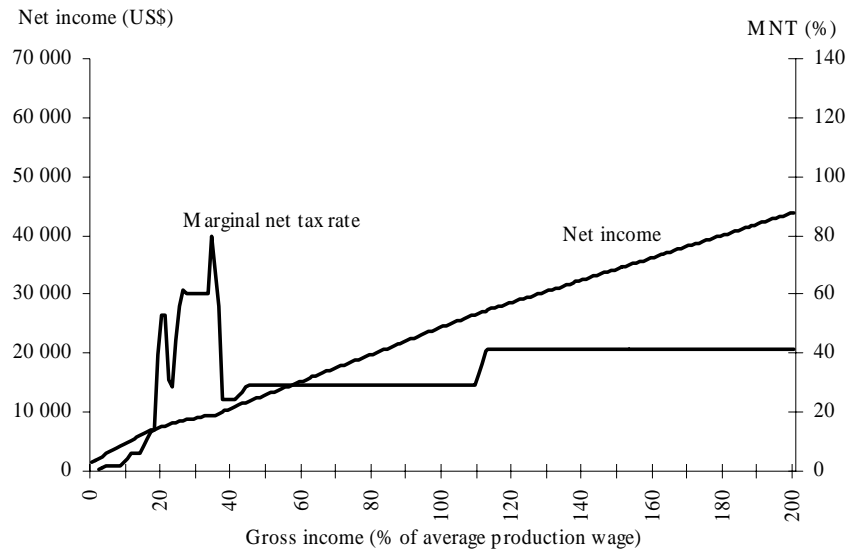


Source: OECD (2004)

⁹ Ministry of Finance (2003).

Figure 3 shows the situation for the same type of individual in the US. Whereas the material work incentives for the poor in Sweden are non-existent, in the US they are rather strong.

Figure 3: Work incentives in United States in 2002 for a single person with no unemployment insurance



Source: OECD (2004)

Clearly, the difference between Sweden and the United States is fundamental, and one might suspect that the OECD-data for example does not include state level benefits. But the documentation clearly state that because tax and benefit systems vary from state to state, OECD has used the State of Michigan to represent a typical manufacturing region. OECD states that Michigan benefits are somewhat above the average for all States.¹⁰ As for Sweden, Figure 2 based on OECD-data looks close to identical to the one I myself produced for the 1995 situation in Sweden (see figure 5 in Bergh (2004)). I have also verified that the qualitative and fundamental differences between the United States and Sweden is not

¹⁰ All documentation and data for OECD (2004) is available online: [Link](#).

driven only because the comparison is made for a single earner with no children—the same point could be made with any household type.

The lack of material incentives in Sweden is to some extent made up for by rules requiring social-assistance recipients to be actively looking for jobs. Also, in some cases, they are required to participate in public employment projects. Nevertheless, by comparing Figures 2 and 3, it is evident why in the United States the poverty debate is focused around the ‘working poor,’¹¹ whereas the Swedish debate is centered around benefit dependency and separation from the regular labor market.

The level and length of the flat segment on the net income curve depends on the type of household and the amount of approved expenditures covered by social assistance. More children and higher approved expenses mean higher total benefit and thus also a bigger poverty trap, in the sense of a longer flat segment on the net income curve.¹²

The difference between work incentives in Sweden and the United States can be explained by fundamental differences in the tax and benefit systems. Swedish policymakers have opted for high social assistance as described above *and* high taxation of low-income earners. American policymakers have chosen the opposite strategy: The Earned Income Tax Credit essentially subsidizes low wage employment, while those who do not work receive very little public support.

The taxation of the very poorest in Sweden is higher than even many Swedish social scientists probably realize. Recipients of social assistance pay income taxes at roughly 30 percent on their earnings. When a social-assistance recipient increases her income by 100 SEK, she pays 30 SEK in local income taxes, and social assistance is decreased by 70 SEK. Moreover, employers pay wage taxes at roughly 30 percent of those wages. Thus, when the social-assistance recipient increases her income by 100 SEK, the public budget is improved by approximately 130 SEK, but her private budget is improved by 0 SEK.

To sum up, the Swedish system sends a clear signal: Work only pays materially if you can get a job that pays at least half the earnings of an average production worker. The system in the United States is a stark contrast: Even if the only job you can get pays less than a fifth of that of the average production worker, you are better off working.

¹¹ See for example Ehrenreich (2001).

¹² Note also that because the cash amount is fixed, and the rest of social assistance covers expenditure, there are no economic incentives for individuals to cut down on approved expenditure.

Table 1 showed that weak work incentive in Sweden is not only a problem for the poorest. High-level, income-related social insurance benefits imply that the material improvement when accepting a job is small also for many middle-income earners. However, because of the construction of social assistance, the complete poverty trap with 100 percent marginal net tax rate applies only to the poorest.

In his table 10.2, Lindert, for some reason, reports marginal net tax rates for the United States and the United Kingdom both with and without the Earned Income Tax Credit (EITC), and the similar Working Families Tax Credit (WFTC) in the United Kingdom. His arguments hold in theory when comparing universal welfare states to those relying on strict means testing. But they do not apply to the Sweden-United States comparison. As clearly shown by Lindert's data, the EITC has had a very big positive impact on work incentives for the poor, whereas Sweden has nothing similar to alleviate the negative incentive effects of its strictly means-tested social assistance scheme.

Lindert asks: "If welfare states really have lower marginal tax rates at the top and bottom of the income spectrum, but higher tax rates in the middle, do they discourage work more or less than the low-budget governments of Japan, Switzerland and the United States" (249)?

The question is odd because the structure of the marginal net tax rates in Sweden is exactly the opposite of Lindert's description—high for low and high-income earners, and lower for middle income earners (see Bergh (2004)).

I can only conclude that Lindert's description of work incentives in Sweden is wrong. For this reason, one of Lindert's keys to understanding the free-lunch puzzle is fundamentally shaky. On page 245, a sub-heading reads "The Poor May Face Lower Work Disincentives in the Welfare State." Well, in theory they might, but in Sweden, they don't.

Employment of women in Sweden

A second point where Lindert misrepresents the situation in Sweden is employment, especially for women. He writes, "relative to other OECD countries, Sweden's institutions seem to produce greater employment, especially jobs held by women and the elderly, with positive effects on GDP" (281). And, "virtually all of Sweden's employment growth between the 1960s and the early 1990s consisted of jobs for women" (282).

From these quotes, it is evident that Lindert wants to use high female employment as another explanation of the free-lunch puzzle. To support his claim he uses OECD data on employment ratios (Table 11.3, 282). The employment ratio, however, is a very blunt measure of employment. It tells you whether a person is employed, but not how much she works. High and increasing employment among women or elderly can explain the Swedish GDP level and growth only if Sweden scores high when it comes to actual number of hours worked, as opposed to employment ratios.

To explain high female employment in Sweden, Lindert combines two facts: “Sweden’s women get better pay relative to men than in any other OECD country” and “women have a more elastic labor supply than men” (282). He also stays with his theory that high gender equality is an explanation of the free-lunch puzzle: “Women have a more elastic labor supply than men, and that converts gender gaps into effects on *total work* and GDP” (287, italics added). When we consider the number of hours actually worked instead of employment ratios, however, total female employment in Sweden is actually lower, not higher, than in the United States.

It has long been known that the seemingly high gender equality on the Swedish labor market is much less impressive once you look at the actual numbers of hours worked. In a paper titled “Women and Market Work: The Misleading Tale of Participation Rates in International Comparisons,” Jonung and Persson (1993) showed that behind a gender difference of only 5 percentage points in labor force participation in 1998, there is a difference of 12 percentage points when the actual number of hours worked are taken into account. By using employment ratios, Lindert hides the fact that Swedish women work fewer market hours than Swedish men, and they spend more time in unpaid non-market work.

By taking into account the actual number of hours worked, Henrekson (1998) reports adjusted employment ratios comparable to those reported by Lindert. The results for Sweden and the US are shown in Table 2. When actual working hours are taken into account, we find that Lindert is mistaken about Sweden having higher female employment.

Table 2:
Female employment and hours worked in Sweden and the US (1994)

	Employment ratio ¹³	Hours worked per week	Employment ratio adjusted for hours worked ¹⁴
USA	66 %	36	62 %
Sweden	71 %	28	51 %

Source: Henrekson (1998).

International comparisons of working hours are difficult because of variation in definitions and methods. As shown in Table 3, alternative sources differ in their reported levels. But they still confirm that the big difference between the United States and Sweden is that both men and women in the United States spend more time in market work compared to their Swedish counterparts.

Table 3:
Market work per week for men and women
NB: Alternative sources¹⁵

Market work per week (avg hours)		
	USA	Sweden
Men	42	38
Women	36	33

I am inclined to reject Lindert's elastic labor supply explanation of Sweden's high female employment ratio. What is the better explanation? Again, the answer seems obvious and not very controversial: The expansion of the public sector. Lindert tells us that "all of Sweden's employment growth between the 1960s and the early 1990s consisted of jobs for women" (282). He does not tell us that in Sweden, there has been no net

¹³ These numbers are reported by Lindert in his table 11.3.

¹⁴ This equals number of hours worked per week * (52/2000)*employment ratio.

¹⁵ Source: Table 17 in Nelander and Goding (2005) for Sweden (data for 1994), and table 1 in Rones et al. (1997) reporting data from 1995. Note also that according to standard OECD data, Americans (men and women together) spend approximately 200 hours more in market work every year compared to Swedes, see for example OECD Productivity Database, available at online: [Link](#).

growth of jobs in the private sector since 1950, as shown in Figure 4, taken from Davidsson and Henrekson (2002).

Figure 4:
Cumulative change of private employment, government employment and population in Sweden (in thousands), 1950–98



Source: Davidsson and Henrekson (2002).

Clearly, there is important information contained in both the employment ratios and the number of hours worked. By focusing on the 5 percent that separates Sweden from the United States in terms of employment ratios, one could argue that for these women, having an independent income from the public sector is preferable to being

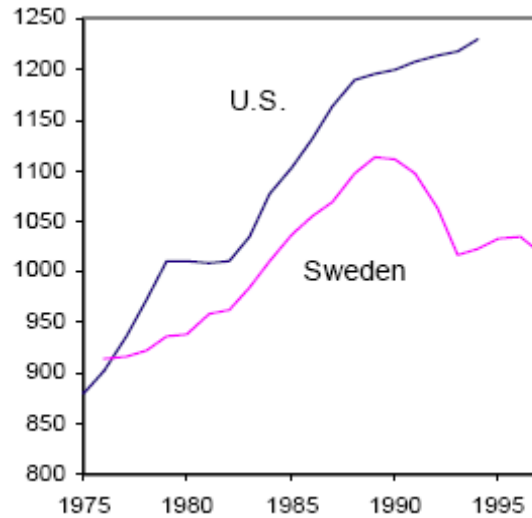
dependent on a husband. However, when Lindert is aiming to explain “total work and GDP,” displaying only employment ratios is not convincing.

Furthermore, by ignoring the distinction between employment ratios and hours worked, Lindert’s comparisons between Sweden and the United States become very biased. Hakim (1996) has shown that when it comes to female employment, Sweden is surprisingly similar to other countries: “[t]he rise in female employments rates is due primarily to the creation of a new part-time workforce (the USA being a rare exception)” (61). Highlighting American exceptionalism, Hakim adds “Only the USA has had a steady and accelerating growth in women’s employment” (65).

Hakim’s reading of the differences between Sweden and the US is robust to the choice of years for comparison.

Figure 5 depicts the development of annual hours worked over time in Sweden and the United States. From this development it seems to be clear that high female employment is indeed a factor explaining growth differences between Sweden and the United States. But the factor favors the United States, not Sweden.

Figure 5: Average Annual Hours Worked Among Working Age Women in the U.S. (1975–94) and Sweden (1976–97)



Source: Henrekson and Dreber (2005).

Because Lindert fails to identify these fundamental differences between Sweden and the United States, he also fails to discuss possible theoretical explanations of the pattern. Once again, the answer is obvious and uncontroversial: To finance the expansion of the public sector (depicted in Figure 4), Sweden has increased labor taxation substantially.

High tax wedges on labor have several effects. In this context, one important effect is that it becomes more expensive for a person to hire another person to do any type of job. When one person hires another person, labor taxation enters repeatedly in the total tax wedge. First the hiring person must earn money and pay taxes. With her after-tax income, she hires another person, who once again has to pay taxes. In addition to income taxes, the same goes for wage taxes if such exist.

DuRietz (2004) computes the total difference between what the hiring person must earn and what the person she hires will keep in a number of countries, assuming that the hiring person earns twice as much as an average production worker and the hired person earns the average production-worker wage. Based on his data, I have computed the total “person-to-person” tax wedge for a number of countries, in a way that makes them comparable to standard business-to-person tax wedges.¹⁶

Table 4 shows that this person-to-person tax wedge is much higher in the Nordic welfare states compared to the US. It should be noted that these tax wedges are extreme also by the standards of high tax countries. For comparison, I have also included standard (business to person) OECD tax wedges in table 4. We see that the tax wedge when a business hires a person is much smaller.

¹⁶ For example, DuRietz shows that to hire a person in Sweden that will keep 1000 SEK, you must earn 2611 SEK, which in turn means your employer must pay an additional 6013 SEK. The tax wedge will be $(6013-1000)/6013 = 0.83$, indicating that 83 percent of the total cost is taxed before 1000 SEK eventually reaches the one who does the job.

Table 4:
Tax wedges and female hours worked in different countries

Country	Person to person tax wedge, (%)	Standard OECD tax wedge (%)	Hours worked per week for women
Belgium	90	48	31.9
Denmark	85	38	31.3
Germany	85	44	33.4
Sweden	83	46	27.6
Italy	81	48	34.4
Netherlands	80	40	22.9
France	75	44	34.9
Ireland	69	32	32.8
UK	68	30	29.5
Portugal	67	30	37.7
Spain	67	36	34.7
USA	60	28	35.8
Japan	52	17	37.1
Luxembourg	-	34	34.4
Greece	-	35	37.6

Source: Person to person tax wedge computed from table 2 in DuRietz (2004), data for 2001. Standard tax wedges are from OECD (2000) Taxing Wages, data for 1995. Female hours worked are from Henrekson (1998), data for 1994.

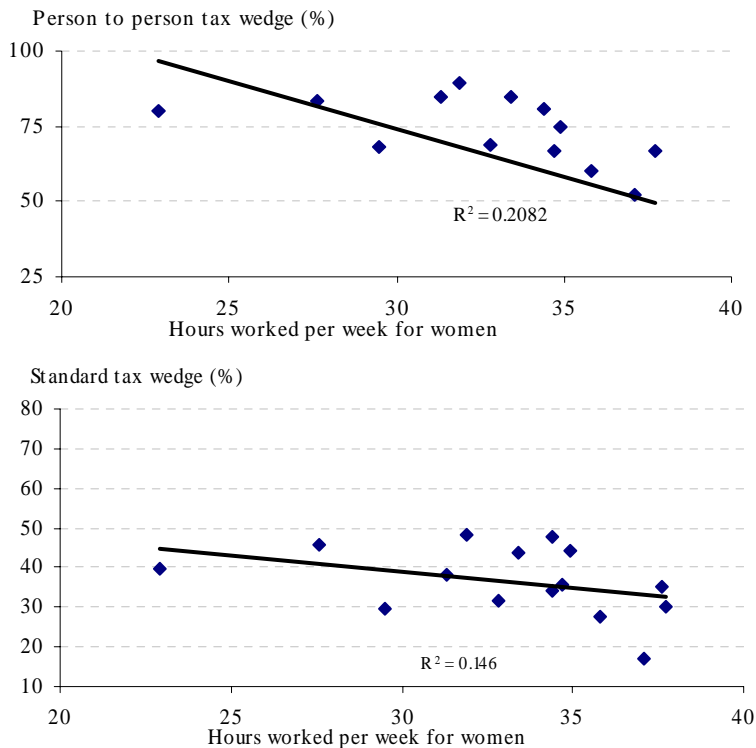
The simple alternative to hiring someone to wash your windows or repair your plumbing is to do it yourself. The higher the tax wedge, the higher must be the productivity difference between the hired professional and doing it yourself. If the tax wedge is too high, you do not work a full day and hire a professional to clean or windows or repair your plumbing, but rather take the day off (foregoing income) and do it yourself. This suggests that one reason for the low hours of female market work is that tax wedges make it harder for working women to hire someone to do household work.

If the tax wedge explanation holds, there should be a negative relation between female employment in terms of hours worked and tax wedges. As shown in Figure 6, this relationship is clearly visible using standard OECD tax wedges and, even more so, when using person-to-person tax wedges. While the sample is too small to do a multivariate

analysis, it seems unlikely that this correlation is driven entirely by omitted variables.

Thus, I suggest the following mechanism as an alternative to Lindert's explanation based on wage equality. Big welfare states have high female employment rates, because the public sector employs (mainly) women to do certain tasks that (mainly) women did before the expansion of the state, namely, caring for children, the convalescent and unwell, and the elderly. Simultaneously, the taxes necessary to pay for the public sector hinder the market for household services. The do-it-yourself incentive created by the welfare state helps explain why working women in big welfare states less often work full-time.¹⁷

Figure 6:
Average hours worked per week for women and tax wedges¹⁸



¹⁷ For further evidence, see Hakim (1996), table 3.3.

¹⁸ Source: See table 4.

Employment of the elderly in Sweden

Lindert also wants to use high employment among the elderly as an explanation of the free-lunch puzzle. Again he uses the employment ratio to illustrate Sweden's allegedly high employment among elderly, and his argument is vulnerable to the same criticism as for female employment: He has not verified that the high employment ratio in the age group 55-64 implies that Swedish elderly actually work more hours.

However, Lindert also uses the retirement age to make his point. On page 289 under the heading "Late Retirement" he writes:

Knowing that Sweden has generally had a low rate of unemployment, one is prepared for the news that Sweden helped that rate look low by removing older workers from the labor force.

Yet the opposite is true of Sweden. Swedish men work to later average retirement ages than men in any other core OECD country except Japan, Norway and Switzerland [in a footnote attached here, Lindert also excludes Iceland, Korea and Luxembourg].

Swedish women work to later average retirement ages than women anywhere else in the world. Continuing work at advanced ages is one of the many ways in which Sweden achieves higher GDP per capita.
(289, emphasis added)

Despite the allusion to OECD, OECD data does not support Lindert's claim. For both men and women, the retirement age in Sweden is only a few months higher than the OECD average, as shown in Table 5.

**Table 5: Average effective age of retirement (in years)
versus the official age, 1997-2002**

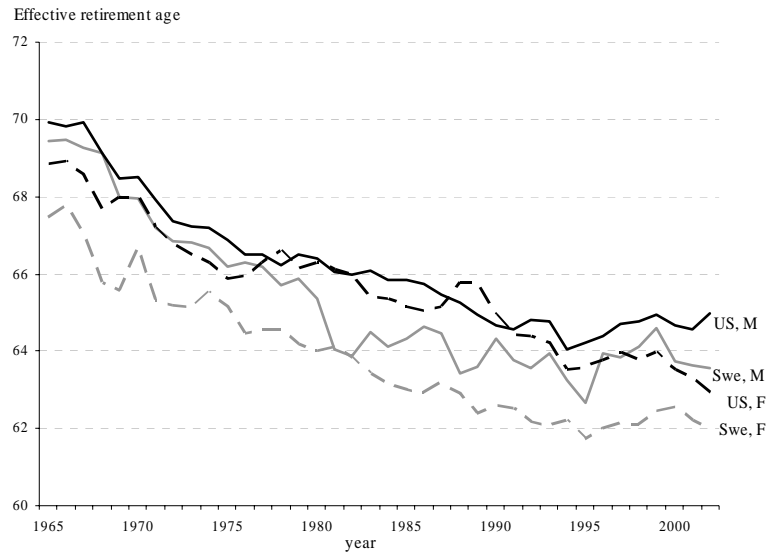
	Men		Women	
	Actual	Official	Actual	Official
Iceland	69.6	67	67.8	67
Mexico	73.8	65	67.2	65
Korea	68.0	60	66.8	60
Ireland	65.2	66	66.2	66
Japan	69.6	60	65.7	60
Portugal	65.8	65	63.5	65
Switzerland	66.6	65	63.2	63
United States	65.0	65	62.9	65
Norway	63.7	67	62.3	67
Denmark	65.3	67	62.1	67
Sweden	63.5	65	62.0	65
Turkey	62.5	60	61.9	58
OECD	63.3	63.9	61.4	62.6
Canada	63.1	65	61.4	65
Spain	61.6	65	61.3	65
New Zealand	64.3	65	61.3	65
U.K.	63.1	65	61.2	60
Greece	62.4	58	60.9	58
Australia	63.2	65	60.6	62
Italy	61.2	65	60.5	60
Germany	60.9	65	60.2	65
Luxembourg	59.8	65	59.8	65
Finland	60.8	65	59.8	65
France	59.3	60	59.4	60
Netherlands	61.0	65	59.1	65
Austria	59.6	65	58.9	60
Poland	60.9	65	58.8	60
Czech Rep.	62.0	61.2	58.3	59.3
Belgium	58.5	65	56.8	62
Slovak Rep.	59.4	60	56.1	55
Hungary	57.8	62	56.0	58

Source: OECD (2005).

Lindert writes, “Swedish women work to later average retirement ages than women anywhere else in the world”, yet women in Iceland, Mexico, Korea, Ireland, Japan, Portugal, Switzerland, United States, Norway and Denmark work longer. This is a remarkable mistake, and it seems appropriate to ponder possible explanations: Perhaps Lindert referred to the official rather than the actual retirement age? Or perhaps he used older data from OECD? Neither of these explanations apply: Official rates are higher in many countries. The 2001 version of OECD’s “Society at a Glance” contains data for the period 1983-88 and 1994-99, but those data do not support Lindert’s claim.

Figure 7 shows that never in the period of data availability has the actual retirement age been higher in Sweden than in United States. To conclude, Lindert’s description of employment among the elderly in Sweden is not supported by data, and thus also fails as a potential explanation of the free-lunch puzzle.

Figure 7:
Trends in average effective age of retirement
for men and women in Sweden and USA



Source: OECD (2005).

SWEDEN'S TRAJECTORY: A DIFFERENT INTERPRETATION

It has been shown that Lindert does not succeed in explaining the free-lunch puzzle in general, nor in explaining Sweden's political and economic trajectory. I will conclude by suggesting an alternative interpretation of Sweden's development, one that is not considered by Lindert: Increasing economic freedom.

In a chapter titled "On the Well-known Demise of the Swedish Welfare State," Lindert notes a repeated theme in the Anglo-American press in the period 1977-1998: "That Sweden's economy was falling behind and that its welfare state was to blame" (264). The following quote is typical of Lindert's way of explaining the survival of Sweden's welfare state.

Given Sweden's insistent egalitarianism, most outside observers also presume that Sweden's tax system is highly progressive, taking over 70 percent of income from rich people at the margin and giving it to the poor. Sweden's actual tax practice is so far from these natural perceptions that we can gain a great deal of insight just by describing features of the system, without trying to quantify its growth effects. (287)

Something upon which Lindert does not reflect is that Sweden's top marginal tax rates peaked at 87 percent in 1979, and remained well above 70 percent throughout the 80s. Thus, for a long time the presumption of "outside observers" was in fact correct. However, perceptions of Sweden have most likely lagged reforms that accelerated in the late 80s.

Lindert notes correctly that during the economic crisis of the 1990s high taxes and public expenditure persisted, and that the degree of universality of the Swedish welfare state did not decrease substantially—see for example Rothstein and Lindbom (2004) and Bergh (2004). But in Lindert's world, the resilience of the Swedish welfare state is used to support his claim that the demise of the Swedish model was mistaken. My alternative interpretation is that many aspects of the Swedish welfare state did in fact cause big problems, and that Sweden's resilience has been the result of a gradual adaptation, in which many of the problems identified by the critics were at least partially addressed.

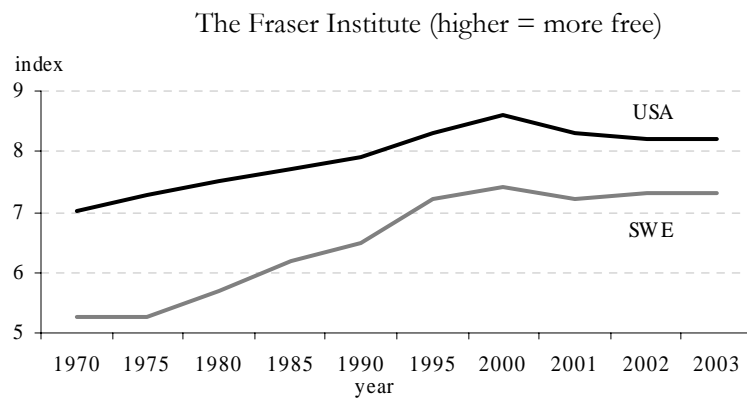
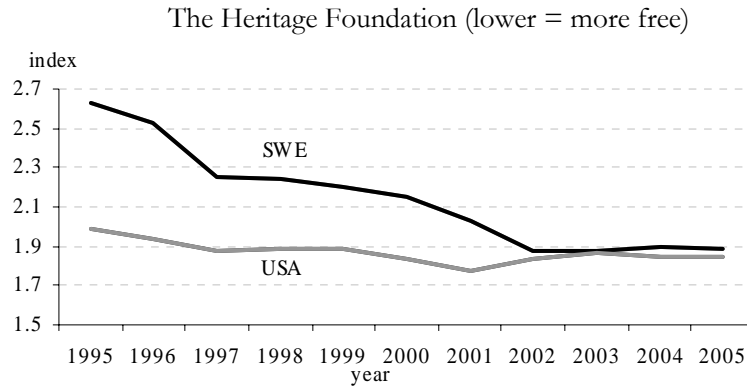
Starting in the 1980s and continuing at least until the mid 1990s, Sweden implemented an impressive series of reforms, increasing the efficiency of its economic system. Table 6 provides a summary.

Table 6:
Some important reforms undertaken in Sweden in the 80s and 90s

1985-89: Deregulation of the credit and currency market.
 1990: The initiation of a process of deregulation of markets with a state monopoly: electricity, postal services, telecommunications, railroads and domestic airways.
 1990-91: A tax reform decreases the top marginal tax rate from 73 to 51 percent.
 1990-97: Central bank independence and a new macro economic policy.
 1991-1995: Sweden applies for EU membership and joins the European Union.
 1991-2000: A number of state owned enterprises are at least partially sold.
 1992: The use of vouchers to introduce competition among schools starts expanding. Vouchers are increasingly also used for child care, elder care and other public services as well.
 1993: The legalization of private, for-profit employment agencies.
 1994-98: The introduction of a new, partially funded pension system.
 1997: The introduction of a new budgetary process with upper expenditure limits.

While these reforms had little effect on quantitative aggregates such as tax or expenditure shares of GDP, they were qualitatively important and contributed to changing the structure of the Swedish economy. One way of illustrating this is to examine the development of economic freedom in Sweden, as measured by the indexes developed by the Heritage Foundation and the Fraser Institute, shown in Figure 8.

Figure 8: Economic freedom indexes in Sweden and USA



Sweden starts from much lower level of economic freedom, but the gap between Sweden and the United States has been closing. Sweden's gains in economic freedom also separate it from other high-tax European countries such as France, Germany and Belgium. The Nordic welfare states all share the fact that they have increased economic freedom faster than the rest of Europe.

To some extent, this development is acknowledged by Lindert. He mentions the tax reform and blames Sweden's poor growth performance on its macro economic policy until the floating exchange rate (unintentionally) adopted in 1992. But that's about it. Lindert does not attempt to describe the major developments indicated by Table 6 and Figure 8. Looking at these changes, the reforms toward increased economic freedom seem to be a good candidate for explaining the survival of the Swedish welfare state.

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