ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

OECD BETTER POLICIES FOR BETTER LIVES

OECD Better Policies Series

Sweden Policy Brief

MARCH 2015

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Inequality

ACHIEVING GREATER EQUALITY OF OPPORTUNITIES AND OUTCOMES FOR ALL

- Sweden's level of income inequality is low by international standards but has steadily increased since the mid-1980s, faster than in any other OECD country.
- The long-term rise in income inequality was driven by widening gaps in market income, but also by weakening redistribution: tax rates fell and out-of-work benefits grew more slowly than wages.
- Reversing the increase in inequality requires a policy package built on three pillars: promotion of inclusive employment, improvement of the redistributive effectiveness of the tax and benefit system and further investment in education and skills.

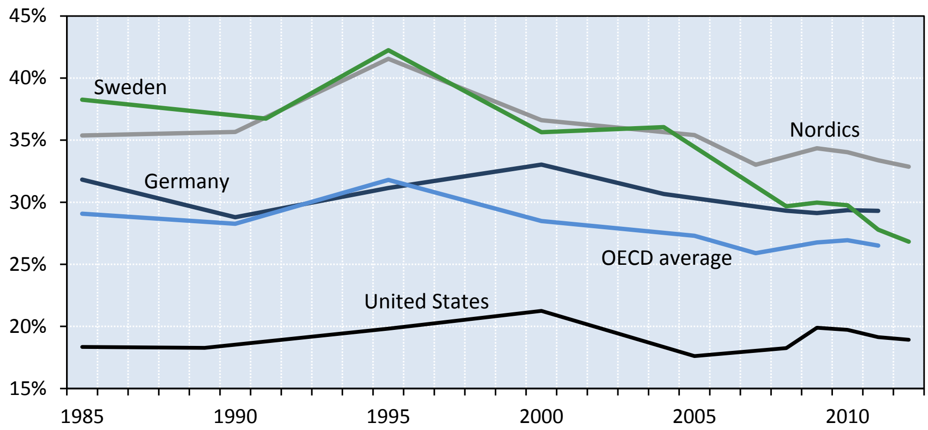
What's the issue?

Sweden still belongs to the group of the 10 most equal OECD countries, despite a sharp rise in income inequality since the mid-1980s, the largest among all OECD countries (more than 7 points in terms of the Gini inequality coefficient). In 2012, the average income of the top 10% of income earners was 6.3 times higher than that of the bottom 10%. This is up from a ratio of around 4 during much of the 1990s. At the top end, Sweden's top 1% earners saw their share of total pre-tax income nearly double, from 4% in 1980 to 7% in 2012. Meanwhile, relative income poverty – the share of people living with less than half the median income – has increased from around 4–5 % during the 1990s and early 2000s to close to 10% today.

In Sweden, income taxes and cash benefits reduce inequality among the working-age population by about 27% – slightly above the OECD average of 26%. This redistributive effect however has weakened over time as it used to range between 35% and 40% prior to the mid-2000s. As in most other Nordic countries, tax reforms over the 1990s and 2000s have decreased the tax burden, especially for wealthier households (e.g. by decreasing capital taxation and lowering or abandoning wealth taxation). At the same time, benefit reforms and changes in mechanisms to uprate their levels made the cash transfer system more targeted but less generous.

The redistributive effect of the Swedish tax and transfer system has weakened over time

Percentage difference between income inequality before and after taxes and transfers



Note: The OECD average is computed over the following countries: Canada, Denmark, Germany, Finland, Israel, Italy, Netherlands, New Zealand, Sweden, United Kingdom, United States.
Source: OECD Income Distribution Database, http://oe.cd/idd

Policies to strengthen work incentives have helped to promote labour market participation. However, low-skilled people are less likely to be employed in Sweden than in many other OECD countries, partly due to high entry-level wages. As a result, market-friendly reforms helped the economy grow but the trimmed social safety net eroded the relative living standards of low-skilled people, which partly explains the rise in income inequality.

The education system therefore has a key role to play in reducing inequality. Good quality education ensures that new entrants have the necessary skills. Enrolment rates for early childhood and primary education are high in Sweden, but graduation rates for upper secondary education are below the OECD average and 15-year olds' PISA scores have deteriorated over time. Students from wealthy and highly educated families also seem to have benefited more from the education reforms than students from disadvantaged backgrounds. There are signs that segregation has increased. Traditionally high intergenerational mobility may thus risk declining as a result of rising inequalities in the education system.

Why is this important for Sweden?

Reducing income inequality would contribute not only to a fairer but also to a stronger economy. Recent OECD research has shown that the long-term increase in income inequality has curbed economic growth in the OECD area. Over a 25-year horizon, a 1 Gini point increase in inequality is estimated to drag down average growth by around 0.1 percentage point per year, with a cumulative loss of some 3% in the long run.

OECD work shows further that redistribution through taxes and benefits per se does not lower economic growth. While this does not mean that all redistribution measures are equally good for growth – poorly targeted policies that do not focus on the most effective tools can lead to a waste of resources and inefficiencies – it means that there can be both an efficiency and equity role for tax and benefit policies, especially when they are linked to inclusive labour market, education and training policies.

What should policymakers do?

- Implement measures to reverse the trend of weakening redistribution, both on the tax side (e.g. re-balancing the taxation on labour and capital or making capital taxation more neutral across types of assets) and the benefit side (e.g. extending the coverage of unemployment insurance; considering changing the current indexation of benefits).
- Continue to invest in education and active labour market policies, along the lines of the recent strengthening of apprenticeship and work placement in vocational education programmes.
- Ensure better transition of young NEETs into the labour market and reduce early dependency on disability and other benefits via a greater focus on education and employment measures.

Further reading

OECD (2015), *OECD Economic Surveys: Sweden*, OECD Publishing, forthcoming.

OECD (2014), *Focus on Top Incomes and Taxation in OECD Countries: Was the Crisis a Game Changer?*, OECD Publishing. http://www.oecd.org/els/soc/OECD2014-FocusOnTopIncomes.pdf

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