

Working Paper



Sweden vs. The United
States of America

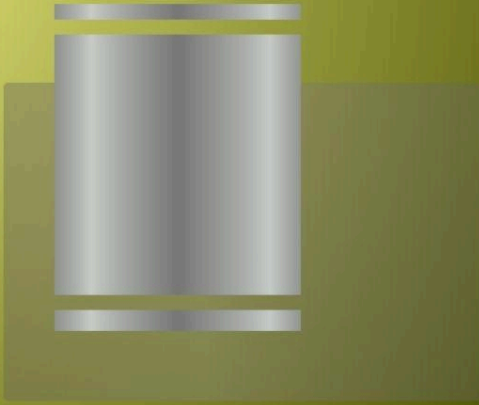
**A COMPARISON OF WELFARE
SYSTEMS**

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Introduction

Sweden and the United States are member countries of the Organization for Economic Co-operation and Development (OECD). The welfare state in Sweden is relatively large - the total amount spent on social programs in Sweden is 60% of the GDP versus 35.5% in the U.S. The spending structure, especially in terms of household transfers, subsidies, and social security, is also informative: 11% in the U.S. compared to 20 % in Sweden -- making Sweden the highest spender on public services among OECD countries, based on 2012 estimates. In terms of monthly earnings based on 1999 estimates, the average worker with 15 years of experience earned \$2,498 in the U.S. versus \$1880 in Sweden.

In terms of family benefits, every parent in Sweden receives an average of \$1800 per child in yearly benefits until the child is 16 (extended if the child pursues higher education), regardless of the parents' income. No such extended benefits exist in the U.S. (unless one or both parents die or become disabled). The U.S. does provide a child care tax credit of \$500, but only for low-income families. Swedish parents also receive paid parental leave - one year and 3 months, at an 80% replacement rate. The U.S. Family and Medical Leave Act guarantees 12 weeks of unpaid leave.

Regarding poverty alleviation programs, Temporary Assistance for Needy Families (TANF) provides up to \$580 in benefits for U.S. households with zero income. Socialbidrag is the Swedish equivalent of TANF and provides \$888 in monthly benefits. On the basis of the differences in the welfare structures outlined for both countries, the following research question emerges: Why does the welfare system in Sweden provide more generous benefits and payouts than the U.S. welfare system?

Perspective I

Perspective I (Rogowski and Kayser): The electoral system in the U.S. is majoritarian and so spending programs are limited to specific geographical districts; in contrast, the Swedish electoral system is proportion-based so larger, universal spending programs are enacted.

Rogowski and Kayser (2002) propose that proportional representation empowers producers and slants policy in favor of the producer, putting the consumer at a disadvantage. Owing to this slant, prices of goods and services are higher in proportional versus majoritarian states. Rogowski and Kayser also found that majoritarian systems are prone to less distribution than proportional systems. Empirical evidence exists concerning the dynamics of the relationship between electoral rules and fiscal policy. Studies have shown that in federalist majoritarian systems like the U.S., where geographical districts elect individuals as government representatives, spending programs will usually be targeted to specific locations (pork barrel spending). In non-federalist Sweden, where the electoral system is proportional, each district has more than one representative so universal spending programs are the norm.

Empirical studies by Milesi-Ferretti, Perotti and Rostagno (2002) and Persson and Tabellini (2000) found high correlation between electoral system proportionality and the amount of government transfers made. For instance, even though certain social policies are federally mandated in the U.S., these policies may find jurisdictional restrictions at the state level.

The Law of One Price proposes that real prices are inversely proportional to real exchange rates, meaning that if prices in Sweden are twice as high as U.S. prices, then based on purchasing power parity, the Krona will be worth twice as much in the U.S. than in Sweden. As of 2007, in the U.S., the post-tax median income for males was \$34, 120 compared to the median male income of kr 232, 680 in Sweden, post-taxes – which, translated in terms of U.S. to Swedish purchasing power – is 2:1, in parity.

The electoral structure supports higher redistribution in Sweden versus the U.S., however, prices tend to be twice as high in Sweden, compared to the U.S.. The slant is indeed in favor of the Swedish producers who support higher redistributive policies but also enjoy higher national pricing structures. The U.S. pricing structure favors the consumer with relatively lower prices compared to Sweden, but U.S. redistribution structures are more restrictive. These findings are consistent with the Law of One Price assertion that prices in proportionally representative countries tend to be higher.

Democracy is expected to be affected by the power of the vote -- voters who believe their investments are threatened by redistribution will be less likely to favor redistributive policies. Democratic principles may also become constrained by elitist tax evasatory tactics. Also, freedom to participate in entrepreneurship activities may inadvertently exclude those who do not have the means to participate, consequently increasing societal inequality.

Perspective II

Perspective II (Acemoglu): The U.S. system of government is structurally decentralized, which has a limiting effect on redistribution policies, whilst the centralized Swedish system provides stronger support for redistribution policies.

The U.S. redistribution system is decentralized, therefore, the structure of benefits are determined at the state level. For example, although the Affordable Care Act (ACA) is a federal healthcare mandate, Texas has opposed the law and has not implemented all ACA provisions. Most significantly, Medicaid expansions have not been made, which means more than 3 million Texans are currently excluded from the benefits provided by the new healthcare system. Only five U.S. states pay sickness benefits that amount to 18-63% of gross earnings.

The Swedish central government mandates health and medical care policies. The government owns all hospitals and national healthcare service is comprehensive (including home and elderly care). The central government, county councils, and municipalities share the burden of healthcare equally - there is no hierarchy among these three structures. Sweden provides universal coverage, with unlimited benefits, including extended hospital stay and medication, to all citizens via a centralized redistribution structure. Sickness benefits have a legislated guaranteed payout of 80% of gross earnings for all citizens. Monthly disability payments are about 80% of the average wage in Sweden, versus 42% in the U.S.

The U.S. has a two-tier pension system - the first, which is the Old Age, Survivors and Disability Insurance (OASDI), also known as "Social Security", provides benefits to the elderly at a replacement rate of approximately 40% for the average wage earner. The second program, Supplemental Security Income (SSI), is for those who have not worked much (or at all) during their lifetime and do not qualify for OASDI. SSI is less generous than OASDI -- the average SSI payout is around \$698 per month. Disability insurance is also provided either via OASDI or SSI and is related to whether or not an individual is working - a person who works and then becomes disabled would be eligible for a generous Social Security pension; an individual who never worked or was disabled from birth would receive a lower SSI pension. So we can say there is a dynamic of inequality at play, depending on the work status of the pension recipient. Social Security provisions and allowances are based on State laws, thus benefits differ from state-to-state.

Sweden has a three-tiered pension system (universal, income-based and premium), but everyone receives the same percentage of benefits, regardless of the region they live in, and of the length of time worked over a lifetime. Per individual, the structure pays 18.5% towards universal pensions, 16% toward current pensions and 2.5% towards the premium fund.

Although the tax and benefits system in both countries are meant to address market income inequality via redistributive means, the U.S. system seems less efficient in so doing: The U.S. Gini coefficient is 0.369 versus 0.252 in Sweden. These inequality figures appear consistent with aggregate spending patterns, especially with social security programs -- less redistribution in the U.S. (higher inequality) seems prevalent when compared with the higher redistributive practices (thus lower inequality) in Sweden.

Perspective III

Perspective III (Alesina and La Ferrara): Expected income growth is higher in the U.S. thus American voters are less likely to support redistribution policies; on the other hand, since Swedish voters have a lower expectation of income growth, the likelihood of finding support for redistribution policies is higher in Sweden.

Alesina and La Ferrara (2001) found empirical evidence in support of their theory that individuals who expect high income growth are not likely to support redistribution policies. Democratic states establish systems to support increased income redistribution, and structure programs aimed at reducing inequality, however, outcomes vary based on the economic class of the population distribution of interest. The Meltzer-Richard model proposes that median voters are in the lowest portion of the population distribution and that democratic principles will reduce inequality via tax policies that increase GDP-based revenue. Acemoglu and Robinson (2006) argue that the relationship between democracy, redistributive policies, and inequalities has nuanced complexities that are not captured by the Meltzer-Richard model.

When comparing the relative earnings of those in the top and bottom decile, the differences in income distribution between the rich, middle class, and poor show distinctive characteristics. In Sweden, the income of the lowest decile is approximately 57% of the median, whilst in the U.S. the median income of those in the lowest decile is much lower, at 39%.

When comparing the 2010 salaries of high and low status occupations, a Swedish doctor earned 2.3 times more than a bus driver, but in the U.S., a doctor earns 6 times more than a bus driver. In Sweden, professors earn 40% more than bus drivers, whilst in the U.S. professors earn 60% more. The relationship between professional competence and income is higher in the U.S. than it is in Sweden, so even though income expectations are higher in the U.S., because of greater U.S. wage disparities, the U.S. appears more immobile than Sweden.

In Sweden, investment in human capital development is state financed. Education is free from elementary to university. All post-secondary students receive student aid for living expenses (grants or loans). The U.S. has a higher percentage of privately financed educational institutions from elementary to university -- 27% of students attend private institutions, and state institutions require tuition and fees. Some estimates show that, for a single student, the cost of education can reach \$600,000 over their educational lifespan, especially in the north East, where some students pay as much as \$43,000 per year.

The extent of human capital investment will affect entry in higher paying professional occupations, thus human capital affects social mobility. The U.S. has a higher selection of Ivy League institutions, however, human capital investments are more costly in the U.S., and to a large extent, investments in human capital will depend on the resources of the parents. The costs of education would have to be lowered significantly in order to close the gap for those who cannot afford to finance their education. Alesina and La Ferrara (2012), postulate that in the U.S., those who move up from a lower income bracket reach future levels of income that will cause them to become net losers as a result of redistribution. Parents (who likely moved up in income brackets over their lifetime) and are already burdened with high education expenses are not likely to support redistributive policies that would require higher tax payments in order to supplement state-funded education costs.

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