Comment on
Anders Björklund, Mårten Palme and Ingemar Svensson:
Tax Reforms and Income Distribution:
An Assessment Using Different Income concepts
Markus Jäntti*

The authors' aim is to study how the two Swedish tax reforms affected the equalization of income. I think there are two ways to read the present paper. First, it can be read as an account of the reduction in vertical inequality and the amount of rank-reversals in Sweden over time, with special emphasis on trying to discern changes in these patterns that are due to two major policy events, i.e., the tax reforms. Second, it could be read as an evaluation of how the tax reform fared in its goals with respect to horizontal and vertical equity.

I think the paper succeeds better if read in the first sense, namely as applied income distribution research with an emphasis on policy. Indeed, the authors are able to use some unusual, but in many economists' view very relevant, income concepts in their analysis. In this sense, they surpass many or most traditional analyses. (I do not belong to those economists who think that the distribution of annual disposable income is uninteresting, but for those who do, this study offers more than most papers on applied income distribution research as it focuses on incomes accrued over longer time periods than one year.)

I believe that for the paper to be successful in the second sense I outlined, the authors would need to adopt an approach that differs in many respects from the present one. I should hasten to add that on the first interpretation I suggest, the authors perform well. In some cases one can reasonably argue with some of the authors' particular choices among the sets of feasible alternatives. A paper on income inequality for which this is

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untrue, however, remains to be written. I shall return to why I believe the paper is less successful as an evaluation of the tax reform.

While the tax reform boom of the 1980s had strong proponents, equipped with more or less coherent arguments from economists, it should be borne in mind that any actual tax reform (a) will come about only if policy makers, i.e., politicians wish and (b) is highly affected by political concerns after any economic-theory considerations have been met. The end result may or may not conform to the original, theoretically motivated, recommendations.

A tax reform is, obviously and by necessity, an act of public policy. An evaluation of whether or not the reform was successful cannot be made without knowing what the goals of the reform were. The effects that the authors study are (1) inequality reduction by the so-called first-order incidence method, i.e., abstracting from behavioral responses, separated into (2) inequality reduction with no re-ranking and (3) re-ranking.

In order for these aspects of the tax and benefit system to provide answers to interesting questions, we would like to know what the policymakers’ goals were with respect to these specific issues. As far as I could glean from the paper, these were that (i) the expected adverse distributional consequences of the tax reforms on income inequality should be alleviated by an increase in child allowances (which addresses point 1 above) and (ii) that the possibilities for a taxpayer to reduce the tax burden by shifting among income components were to be reduced by broadening the tax base and neutralizing taxes, thus indirectly addressing point 3.

The authors proceed to disaggregate income inequality as measured by the Gini coefficient for a number of years and look at the time series to observe whether or not something happened as the tax reforms took effect. This is interesting and informative. Looking at figures 3–5, however, I make two reflections. First, a great deal happened with the distribution of income, but not much dramatic or episodic change can, or so it seems to me, be dated to the tax reform years. Second, interesting things seem to have been going on in the years preceding the tax reform of 1991.

To return to my point about evaluating a tax reform, one should think about how the methods chosen by the researcher should relate to the goals of the reform. For instance, imagine that the policymaker formulates a goal regarding a desirable reduction in horizontal equity in terms of annual income. Should not the same concepts be used in the evaluation of the reform? If not, should the reform itself have been planned in
terms of some other income concept? Indeed, given the widespread practice among income distribution analysts in studying the inequality of equivalent income, why shouldn't the tax system itself be planned around such an income concept? And if it isn't, why should tax-related inequality analysis be conducted in terms of equivalent income?

The authors identify horizontal inequity with the amount of reranking due to taxes and benefits. For an identity to be appropriate, that is, for a reranking to always be inequitable, the initial distribution needs to be thought of as equitable, at least as far as the ranking of individuals is concerned. A shrinking of the pre-tax distribution is in this view to maximize vertical equity with no loss due to horizontal inequality. The plausibility of this view, however, is open to debate (see Le Grand, 1987, p. 434).

But let us assume for the moment that the above interpretation of “optimal redistribution” is plausible. Imagine further that the social planner, in our view erroneously, has designed the tax system to be individualistic, i.e., that in setting the tax rates the planner only takes into account the personal income of each taxpayer. Assume there are no rank-reversals due to taxes measured by the planner. It will almost immediately follow that when an income distribution analyst comes along and applies the standard work tools—equivalent income, the household as the income unit and so on—the reform will have failed, in that there will be at least some horizontal inequity.

I remain unconvinced of the need for—indeed the appropriateness of—using alternative income concepts in evaluating a tax reform. I particularly question the usefulness of using lifetime income in that evaluation. How do the effects of a tax reform show up after only a few years if lifetime income is used as the yard stick? After 20 years we might be able to form a picture of the effects of these tax reforms on lifetime income, although by then it is likely that these effects will have been dwarfed by other events in the economy and are therefore difficult to identify.

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