Articles

Perspectives on Tax Developments in Sweden 1950–1977

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In Sweden the total tax yields, as a percentage of GNP, increased from 21 per cent to 50 per cent during the period 1950 to 1976. As indicated in Table 1, this drastic increase was accompanied by substantial changes in the tax structure.

Of this increase of taxes in relation to GNP by 29 percentage points, higher payroll taxes (including contributions to the supplementary pensions scheme and other social insurance payments) accounted for approximately 14 percentage points, personal income tax for about 12 percentage points and the broad based general sales tax and the VAT (value-added tax) for about 6 percentage points. The greater part of the increase in the personal income tax yield is attributable to increased local government taxes. The share of corporate income tax in GNP has declined during the last few years, causing its share in total tax yield to fall from almost 15 per cent in 1950 to below 4 per cent in 1976.

It is obvious that an increase of the tax burden, as sharp as that experienced

Table 1. *The Swedish tax system 1950 and 1976*

	Tax yield			
	1950		1976[a]	
	As percentage of total tax revenue	As percentage of GNP at market prices	As percentage of total tax revenue	As percentage of GNP at market prices
Personal income tax	47.2	9.9	43.7	21.9
Central Government	22.9	4.8	17.3	8.7
Local Government	24.3	5.1	26.4	13.2
Payroll taxes, including employers' contributions	2.1	0.4	28.2	14.1
Corporate income tax	14.6	3.0	3.7	1.8
Other direct taxes	4.1	0.9	1.2	0.6
General sales tax/VAT	–	–	12.6	6.3
Other indirect taxes	32.0	6.7	10.6	5.3
Total	100.0	20.9	100.0	50.0

[a] Preliminary data.

in Sweden during the last couple of decades, implies a strain on the tax system and the fiscal mechanisms. It is also clear that an active central government tax policy lies behind such changes in the tax system. This is reflected, for example, in the fact that the automatic increase in tax liability resulting from the highly progressive central government income tax has forced frequent modifications of the tax system. The structural changes in the system reflect shifts of fiscal policy goals. The decreased importance in public sector tax revenues accruing from the corporate income tax is, partly, a result of shifts in the ambitions of fiscal policy from the 1950's to the 60's and 70's.

The direction of tax policy

During periods of surplus demand in the 1950's the stabilization policy was mainly directed at containing private investment. Some of the instruments used for this purpose were the investment tax, a successive phasing out of the free use of the depreciation allowance for machines and inventories, a stiffening of the rules of stock valuation and successive increases of the corporate income tax rates.

Towards the end of the 1950's this type of fiscal policy was abandoned as economic growth became a more central economic objective. Through the establishment of a revised system of investment funds at the end of the decade and the introduction of a general sales tax in 1960 the burden of the stabilization mechanism was shifted from corporate investment to private consumption. With the emergence of balance of payments deficits from the mid 1960's expansion of industrial investment became a more clearly desired result of policy making. One notes a more frequent use of the investment funds, a liberalization of the use of depreciation allowances and the abolition of the investment tax component of commodity taxation as the general sales tax was replaced by a value-added tax in 1969.

In the policital debate of the latter half of the 1960's interest in economic growth gave way to concerns about the income distribution. An example of the heightened ambitions in this field was the increase in the redistributive effect of the individual income tax after the mid 1960's.

Tax policy of the 1970's

The tax reform of 1970 involving a shift from joint, to individual taxation of spouses was regarded as most fundamental and has proved to be of significance for labor supply development during the 1970's. Increased progressivity was combined with the abolishment of the deduction allowed for local government income tax. The latter meant that an increase in local government income tax no longer automatically implied a lowering of the central government tax liability. This meant that increasing local taxes would absorb a very large part of any increment in income. These effects of the 1970 tax change were, as it happened, accentuated even further by the high rates of inflation experienced in the next few years.

Problems with the Swedish tax system also became acute in the early 70's. Among the solutions suggested were (of course) lowered progressivity or indexation of tax scales. The Social Democratic government, however, opted for *ad hoc* annual adjustments, thus solving, temporarily, the trade-off problem as well as being able to allow a policy aimed at redistributing incomes. These actions were often negotiated in direct relation to the central wage agreements, which added a further dimension to the Swedish tax scene. In effect, such a tax-wage agreement comprises two elements: first, a lowering of the income tax rates as compared to the original system and secondly, a shift towards a larger share of payroll taxes and employers' contributions in the system. The first element provided a solution to the trade-off problem. The second element provided a means of "moving taxation closer to production", to use a phrase coined in the beginning of the 70's. The central idea was to tax incomes to an increasing extent before they were paid out to individuals.

A general business or production tax

The advantages of an increased amount of taxation directly on production rather than on individuals are considered to be partly of a tax administrative and partly of a distribution policy nature. The latter effect is explained by the fact that e. g. payroll taxes reduce the importance of personal deductions compared to a conventional personal income tax. An evaluation of the redistributive effects of increased payroll taxes must, however, also take into account the fact that these taxes are assessed only on so-called wage incomes. It is nowadays a well established belief that, in the long run, payroll taxes generate a regressive effect on distribution, i. e. they act to the disadvantage of the low income earner. It has, therefore, been argued that some kind of production tax should be introduced with a wider base than only income from labor, or that the payroll taxes should be complemented by taxes on other factors of production in order to achieve general taxation of the factors of production.

In a recent IUI publication dealing with corporate and indirect taxation these possibilities have been discussed.[1] In the first part of the book different

[1] G. Normann and J. Södersten, *Skattepolitisk resursstyrning och inkomstutjämning. En analys av företagsbeskattning och indirekt beskattning* (The Use of Tax Policy in Resource Allocation and Income Redistribution – An Analysis of Corporate Taxes and Indirect Taxation). IUI 1978.

types of gross income or gross expenditure taxes have been studied as well as taxes on specific factors of production.[1] The study analyzes a number of *different types* of taxes, on both companies and households, which are compared on the basis of their effects on resource allocation and the distribution of income. We will discuss these effects in the form of traditional differential analysis. This means that the effects of different tax packages with the same impact on for instance total demand or employment, are compared. With this restriction interest is concentrated on the effects from substituting one tax for another – as a rule a proportionate income tax.

Payroll taxes versus VAT

The VAT and the payroll taxes are, without doubt, the most important taxes in the field of gross taxation and taxation of factors of production. A comparison of the effects of these taxes on a macro level indicates that they show important similarities, particularly in a long-term perspective. Both taxes are imposed on firms, but the burden is shifted. The present VAT can be characterized as a proportional tax on consumption, while the payroll tax can be viewed as a proportional tax on wage income supplemented by a tax on entrepreneurial income. Both taxes have, therefore, in the long run, a regressive effect on income distribution. The effects on labor supply and savings appear to be similar.

The dynamic shifting process, however, is probably not the same for the two tax types. The VAT is expected to be shifted forward to prices quickly and, therefore, has limited effects on the allocation of resources in the economy. As far as payroll taxes are concerned, the shifting mechanism has been debated more extensively. By connecting increases in the payroll taxes to central collective bargaining, as has been done several times during recent years in Sweden, an immediate backward shifting of the tax is believed to take place. If this is correct the payroll taxes do not generate any marked effect on the allocation of resources in either the short or the long run.

The critics of this view question, however, whether it is possible to reach an immediate shift of tax burden through institutional arrangements. They also point to the fact that several increases of the VAT during the last few years have occurred without any direct connection with wage negotiations. Therefore, it has been claimed that the increased payroll taxes of the 1970's and earlier have had a detrimental effect on profits and, thereby, on employment and the balance of payments.

[1] To the category gross taxes – which are characterized by the fact that deductions are very limited when the tax base is determined – belong different types of VAT, which are extensively dealt with in the book. Among the taxes on factors of productions payroll taxes, taxes on raw materials, energy and investments are analyzed.

The regressive nature of the VAT and the payroll taxes combined with the tax policy developments during the last few years have brought forth extensive criticism of these taxes in their present form. As regards payroll taxes it has been suggested that so-called non-labor incomes should also be made liable to corresponding taxation. Among the various suggestions that have been made regarding the VAT is one that investments should also be included in the tax base.

Alternate versions of the VAT

A VAT which, beside consumption goods, also includes total gross investments has a base which is equal to the Gross National Product (GNP) if we neglect the public sector. Such a VAT is often called a GNP-VAT. If one allows deductions for depreciation from the tax base of this version of the VAT one ends up with another version called the NNP-VAT or the I-VAT. In this case the taxable base covers the Net National Product or the whole National Income, which is the same thing. This means that, besides wages, also profits, interest, rents, royalties, etc., would be covered by the tax. Both the GNP-VAT and the I-VAT can be characterized as production taxes or general taxes on factors of production and would, therefore, meet the demand for symmetry in the taxation of different components of the National Income. This has been a central issue for many of the criticisms of the present system.

The reformed VAT would, probably, not have the same regressive effect on distribution as does the present system. A tax on investments could, at least in the short run, be expected to be progressive and, thus, counteract the regressivity of the taxation of consumption. The long-term effect on income, distribution, however, is more uncertain. If a shift of the burden of the investment tax were to occur, it would be reasonable to believe that this would be a slow and time consuming process. The progressive effect in the short run would, therefore, persist during a considerable time period. The analysis also indicates that value-added taxes that include gross or net investments in the tax base can have considerable effects on the distribution of resources in the economy, and would, *inter alia,* have a dampening effect on the incentive to invest. In these respects the effects of the GNP-VAT would appear to be more marked than the I-VAT. A comparative analysis of these two versions of the VAT indicates that principal arguments can be put forward against the GNP-VAT in comparison to the I-VAT. Thus, in favor of the I-VAT one can mention criteria such as effectiveness and just coverage of the tax base. On the other hand, one can mention administrative factors in favor of the GNP-VAT.

The effects of the corporate income tax

As already mentioned, the shifts in fiscal policy – from containing investments during the 1950's to stimulating industrial capital formation during the 1960's and 1970's – have to a large extent taken place through the taxation of net corporate profits. The use of corporate taxation as a tool in economic policy focuses attention on a number of questions, not very extensively treated in the literature, about the effects of this tax. Among these are the importance of corporate income taxes for stabilization policy as well as the more long-term effects on the allocation of resources and distribution of income. The second part of the recent IUI book[1] focuses on the long-run aspects, i. e. the effects on income distribution, allocation of resources and growth.

Redistributive effects

A central question that arises when studying the long-run effects on income distribution of corporate taxation concerns factors that determine the rate of return, net of taxes, that the owners of capital would claim. In a small economy with extensive possibilities for investment abroad, there are indications that the required rate of return is determined internationally and is, therefore, largely independent of variations in domestic corporate taxation. From this point of view one reaches, with established economic theory, the paradoxical conclusion that increases in corporate income taxation can easily influence income distribution to the disadvantage of wage earners, i.e., have a regressive effect. Assuming that the discussion deals with a small country, the owners of capital can ensure their rate of return by changing the relationship between investment at home and abroad. Thereby, wage incomes can be affected by slower growth in labor productivity in a long-term perspective.

It is a complicated task to quantify the consequences of this theoretical conclusion. The adjustment process of the economy, given a change in the taxation of corporate profits, may be very slow. During a transition period of perhaps several decades, increases in corporate taxation may have a progressive influence on the distribution of income. To what extent this effect eventually reverses itself through a negative influence in investment and growth is, however, outside the reach of current theory.

[1] See p. 23, footnote 1.

The changing role of the corporate tax

The effective corporate tax rate for Swedish industry has been reduced by half since the beginning of the 1950's. The effective tax rate indicates the tax take in relation to actual profits, i.e., profits gross of accelerated depreciation. The decrease of the effective burden has, however, been unevenly distributed in practice. Companies with a fast and steady growth record combined with high profitability have had the greatest opportunities to take advantage of a tax-free consolidation of profits. Stagnating companies with low profitability that have reported profits only to be able to pay dividends have, on the other hand, experienced a very high tax burden.

It is essential to question to what extent the selectivity of the corporate tax has benefited total growth of the economy. One can argue that the taxation of profits has reinforced the wage policy of the Swedish trade union movement. Through the process of collective bargaining, the trade unions have forced more rapid wage cost increases in industries with low pay than in those with high pay. Therefore, companies and industries with low profitability are exposed to wage demands beyond the reach of the "normal" rate of return, while the successful wage leading firms of the economy have been sheltered from the same negative effects.

With this wage policy approach the rate of structural change in the economy has been speeded up. Weak companies have been eliminated while, at the same time, moderate wage demands on the very profitable companies have created better possibilities for expansion as compared with a wage policy directed at obtaining maximum wages in relation to profits. The very existence of an expansive and profitable "margin" within the corporate sector, which has been able to absorb the people who lost their jobs when less profitable companies were closed down, has been an important prerequisite for this kind of wage policy and for the acceptance of structural change by the trade unions. From this point of view, corporate taxation can be said to have a rational structure through the emphasis put on growing, successful companies.

Concluding remarks

The analysis of corporate and indirect taxation which has been presented in the new IUI publication takes place against the background of the development of tax policy in Sweden, and deals with several of the problems and suggestions that have been debated during the last few decades.

In spite of the fact that the corporate tax, since 1950, has come to play a less significant role for public sector revenues, one can argue that it is still an important tax. Through, for instance, the sharp differentiation between different groups of companies one should take into account systematic effects on the allocation of real resources in the economy. The study has also shown that the conventional opinion about progressive effects on income distribution, can to a large extent, be disputed in the long-run perspective.

The expansive elements in the tax system since 1950 have been the personal income tax, the general sales tax (VAT) and payroll taxes. These taxes have increased significantly. It is, therefore, natural that they have been widely criticized and that suggestions for new types of taxes have been presented. Extensive attention has been devoted to alternate forms of taxation. One should keep in mind, however, that much of the criticism aimed at the expansive elements of the tax system, could as well have been directed against the rapid and accelerating growth of the public sector.