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The Swedish Tax System - Key Features and Lessons for Policy Makers -

Sweden has a worldwide reputation as a high-tax welfare state. Moreover, unlike Denmark – its main competitor for the dubious honor of the world’s highest tax burden – there are thus far no signs of tax weariness at the ballot box in Sweden. On the contrary, Sweden’s dominant social democratic party has won national as well as local elections proposing higher taxes in recent years.

Is Sweden a success? Should the Scandinavian country be a role model or a bad example? In general, nations should not emulate the Swedish tax system. High tax rates and a heavy burden of government have combined to stunt economic performance and lower living standards. This is an unfortunate development for a nation that used to be among the world’s richest – particularly since Sweden managed to avoid World War II and was well-positioned to prosper in the post-war environment.

But the news is not all grim. Despite its reputation as a high-tax welfare state, Sweden has implemented a handful of pro-growth reforms. The comprehensive tax reform that was implemented in 1991, for instance, lowered marginal tax rates and reduced the tax burden on saving and investment. Many of these positive changes have eroded, but Sweden continues to have a very competitive corporate tax regime.

by **Sven R Larson, Ph.D.**

THE TAX SYSTEM – AN OVERVIEW

Key Features:

- Taxes in Sweden consume more than 50 percent of GDP. The aggregate tax burden rose by about 150 percent between 1950 and 1980, but has since that time remained relatively stable.¹
- The top marginal income tax rate is about 57 percent. While punitive, the top rate used to be nearly 90 percent in the late 1970s. While the long-term trend is positive, the short-term trend is unfavorable. The top tax rate had fallen to 51 percent immediately after the 1991 reform.

¹ Figures for 1950-1990 are from: http://skatteverket.se/download/18.dfe345a107ebcc9baf80001378/Kapitel_14.pdf Page 301, Table 14. The 1990, 2000 and 2004 figures are from: “OECD Revenue Statistics 1965-2004”, OECD Publishing, 2005.

- Subnational levels of government play a significant role in the Swedish tax system. The top tax rate on income, for instance, is composed of a 25 percent national tax rate and an average regional/local tax rate of 31.5 percent.
- The 1991 reform created a flat income tax of about 30 percent for nine out of ten taxpayers, consisting only of the local and regional income tax. During the 1990s, however, the legislature gradually subjected more taxpayers to the national levy. Almost half of taxpayers now pay a national income tax of 20 percent, in addition to a combined local and regional tax averaging 31.5 percent. One in five are subject to the higher national tax rate of 25 percent.
- Individual capital income is taxed at a flat rate of 30 percent.
- Corporate income tax rates have been reduced. Prior to the 1991 reform, corporations faced a tax rate of 52 percent. The corporate tax rate initially was reduced to 30 percent and since has been reduced to 28 percent. Sweden has a territorial system, meaning companies generally are not taxed on income earned in other nations.²
- Payroll taxes are a significant burden, totaling nearly 40 percent of income, including a 32.28 percent tax imposed on employers. These taxes finance retirement, sick leave, unemployment, parental leave, and other programs
- Wealth is taxed. Assets are tax-exempt up to SEK 1,500,000 (US\$ 205,863)³ per individual. With some variations, the standard tax rate above that level is 1.5 percent. The death tax, however, was abolished in two steps in 2004 and 2005. This radical tax policy move is unusual for a country like Sweden, where high taxes are a way of life.
- The value added tax is 25 percent, the maximum rate allowed for European Union nations, but there are preferential rates for several items.

Key Observations:

- The tax burden in the Swedish economy tripled between 1950 and 1980. In 1970, when taxes were not much higher than they are in America today, Sweden's GDP per capita ranked fifth in the world⁴. Since taxes passed 50 percent of GDP the country's overall prosperity has dwindled, and the downturn has been most dramatic in measures of the standard of living. In 1970 Sweden ranked third in OECD for individual consumption, 39

² Testimony of Peter Merrill. House Budget Committee, July 22, 2004. Available at <http://www.house.gov/budget/hearings/merrillstmt072204.pdf>.

³ As of May 25, 2006, 1.00 US Dollar (USD) = 7.2864 Swedish Krona (SEK), <http://www.bloomberg.com/markets/index.html?Intro=intro>

⁴ OECD: Annual National Accounts for OECD Member Countries – 1970 and onwards; GDP per capita, adjusted for PPP and denominated in US\$. Available at: <http://cs4hq.oecd.org/oecd/eng/TableViewer/wdsview/download.asp>

percent above OECD average. By 1995, Sweden barely beat the OECD average, ranking 14th with an individual consumption 1.4 percent above OECD average, and has been stagnant since that time.⁵

- A major tax reform in 1991 significantly lowered the top marginal tax rate to encourage growth. The top rate had peaked at 87 percent in 1979 and then gradually dropped to 65 percent in 1990 before being cut to 51 percent in 1991. Subsequent tax increases have since pushed the rate to about 57 percent.⁶ High payroll tax rates exacerbate the damage.
- Although taxes and spending impose a heavy burden on the economy, Sweden otherwise has a market-oriented economy. The Heritage Foundation's Index of Economic Freedom ranks Sweden as the world's 19th freest economy⁷ and the Fraser Institute's Freedom of the World ranks Sweden 24th.⁸
- Sweden is a slow-growth economy. After rising rapidly after World War II, economic performance stagnated once the burden of government reached high levels in the 1970s and 1980s. Since that time, inflation-adjusted growth has averaged less than 3 percent per year.
- Unemployment is now a significant problem in Sweden. The official jobless rate is about 8 percent, but independent estimates show the rate is closer to 20 percent.
- High taxes and excessive regulations have encouraged many large corporations to leave the country. Many individuals also are escaping the Swedish tax system, ranging from high-net worth entrepreneurs to new college graduates. This combination of capital flight and brain drain does not bode well for the future.
- Even the Swedish tax authority tries to avoid Swedish taxes. As noted by the Wall Street Journal, "When it comes to paying taxes itself, the Swedish Tax Authority, responsible for collecting some of the highest in the world, would just as soon keep them as low as possible. It's saving a bundle on the production of slick TV spots that encourage Swedes to file online by producing them in the neighboring free-market, low-tax haven of Estonia. ...Spokesman Björn Tharnstrom told us, "We decided to do it in Tallinn because the costs are lower. One of those costs is taxes, of course."⁹

5 Ibid.

6 "Sa Hoga Ar Skatterna 2003", a report published by Skattebetalarna, the Federation of Taxpayers, a non-profit advocacy group. Available at <http://skattebetalarna.se>.

7 <http://www.heritage.org/research/features/index/countries.cfm>

8 <http://www.fraserinstitute.ca/admin/books/chapterfiles/EFW2005ch1.pdf#>

9 The Wall Street Journal, "Swedish Tax Exiles," May 25, 2006. Available at <http://online.wsj.com/article/SB114850407054162275.html?mod=opinion&ojcontent=otep>

A CLOSER LOOK AT THE TAX SYSTEM

Tax rates and regulations in Sweden are set to raise a given amount of revenues for the public sector – not to generate economic growth. This is a costly choice. When tax regulations are ill conceived and tax rates are too high, the tax system distorts economic activity and hampers growth. As a result, economic activity diminishes and the tax base shrinks. The tax system erodes its own macroeconomic foundation.

The Aggregate Tax Burden

The Swedish government has little interest in reducing the aggregate tax burden. In 2004 total government tax revenues amounted to 50.7 percent of GDP, compared to 49.6 percent in Denmark, the country with the second-highest overall tax burden. By contrast, the U.S. rate – including state and local government – was 25.4 percent.¹⁰

Sweden was not always a high-tax nation. As illustrated in Table 1, the aggregate tax burden after World War II was modest. But over the next four decades, there was a relentless increase in taxation. The tax burden first reached 50 percent of economic output in 1986 and has generally stayed above that level for the past 20 years.

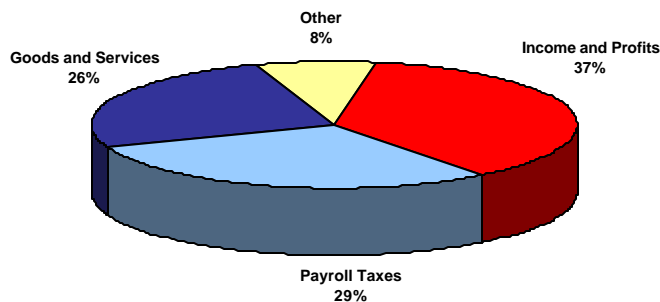
**Table 1:
Sweden's Aggregate Tax Burden
After World War II**

1950	21.0
1960	28.7
1970	39.8
1980	47.5
1990	53.2
2000	53.9
2004	50.7

Source: <http://skatteverket.se/infotext/arbetsgivare/socialavgifter.4.18e1b10334ebe8bc80005862.html>

As Figure 1 shows, the Swedish government sector obtains its revenues from three major

**Figure 1:
Where Sweden Gets Its Tax Revenue**



Source: OECD Revenue Statistics 2005, data for 2003

revenue groups: taxes on income and profits, taxes on consumption, and taxes for social insurance programs. Over the past 25 years the relative importance of each revenue group has changed only gradually, the most noticeable being that taxes on consumption have become more prominent. In 1980 they contributed 23.7 percent of all

¹⁰ Preliminary figures published by Eurostat.

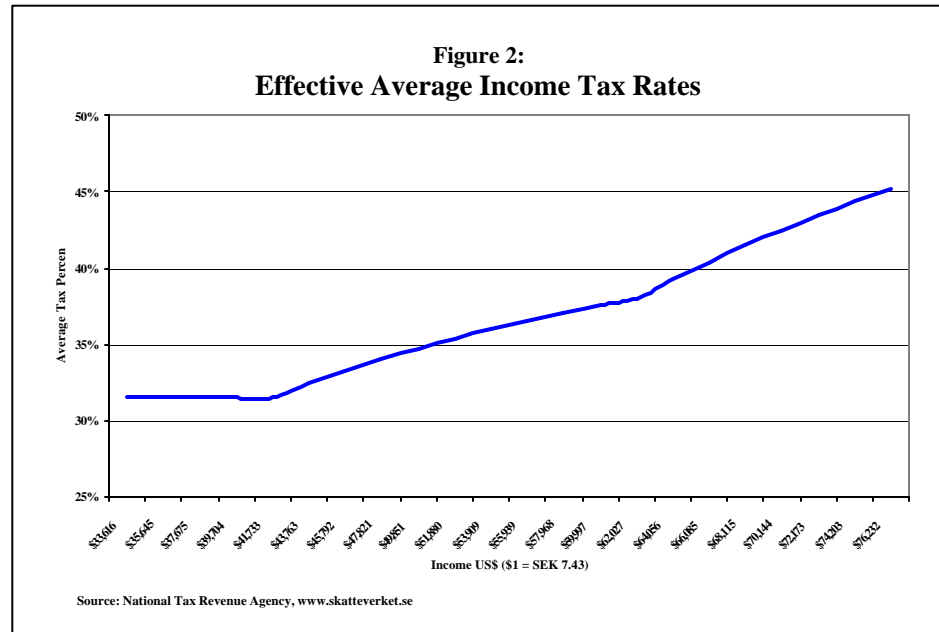
government revenues; since 1992 their share has averaged closer to 30 percent.

The Swedish Tax Regime¹¹

Sweden collects a lot of tax, and they use several sources to obtain revenue. But aggregate tax burdens only tell part of the story. To fully gauge the impact of a tax regime, it is necessary to ascertain marginal tax rates on productive economic behavior. In this regard, Sweden’s personal income tax and payroll tax deserve low marks. The Swedish value-added tax is onerous, but not especially destructive, and the corporate income tax is designed – at least in part – with a recognition that Swedish companies need to compete in a global economy.

The Personal Income Tax: The most noteworthy feature of the personal income tax is that it combines the worst of all worlds. It imposes a very high top tax rate on productive behavior, and the top rate takes effect at a relatively modest level of income. Swedish taxpayers with about

\$60,000 of income will pay nearly 60 percent of each additional dollar to the national, regional, and local governments. This is a steep penalty on work, saving, investment, risk-taking, and entrepreneurship. Even the Organisation for Economic Cooperation and Development, in its Country Report on Sweden, noted, “High tax wedges have a negative impact on hours of work” and that “cutting marginal income tax rates could help improve work incentives.”¹²



Reviewing some of the details of the personal income tax, Sweden has a zero-bracket amount – a threshold level of income that taxpayers can earn before the income tax takes effect. There are no taxes on the first SEK 16,600 (\$2,278) of annual income, though this exempt amount shrinks as income rises – a policy that causes effective marginal tax rates to climb even higher (see

¹¹ The numbers in this section are from the Swedish National Tax Agency, Skatteverket, at www.skatteverket.se, and from Statistics Sweden, at www.scb.se.

¹² Organisation for Economic Cooperation and Development, “Economic Survey of Sweden, 2005,” Policy Brief, June 2005. Available at <http://www.oecd.org/dataoecd/35/32/34967833.pdf>.

accompanying text-box).¹³ The exemption level is decided on by the national legislature; local and regional governments are prohibited from taxing income below this level.

Examples of How Rising Marginal Tax Rates Discourage Productive Activity

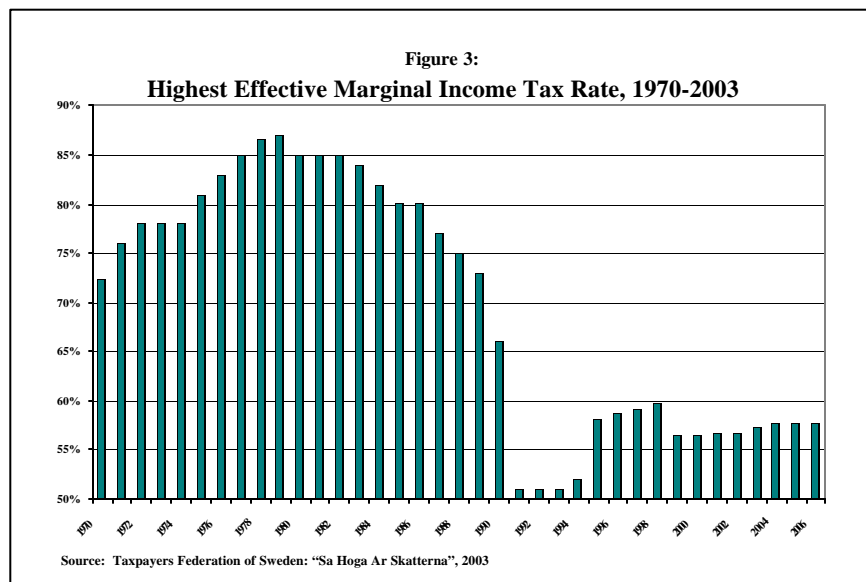
A person earning SEK 250,000 (\$34,310; 86 percent of average income) is eligible to exempt SEK 16,100 (\$2,210) from taxes. Suppose that this person is promoted and receives a 20 percent raise. This means his gross pay jumps by SEK 50,000. But since his total exempt income falls to SEK 11,600, another SEK 4,500 is now subject to flat rate local and regional income taxes. Despite the fact that his statutory income tax rate remains the same, he is now paying that flat rate on an additional SEK 54,500 of his income.

This means that his marginal tax rate has risen, even if his statutory tax rate has not. His pre-tax income rose by SEK 50,000, but his taxable income rose by SEK 54,500. Instead of a tax rate of 31.5 percent, his marginal tax on the promotion raise is actually 34.3 percent.

Suppose our Swede is promoted again, receiving another 10 percent raise, boosting his income to SEK 330,000. He will now be liable to pay the national income tax on his earnings above SEK 313,000 (\$42,957). The tax taken out of his 10 percent promotion is thus 31.5 percent in local and regional taxes – SEK 9,450 – and SEK 3,400 in national income tax. In all, the marginal tax on his raise is 42.8 percent – a high effective marginal tax rate for Swedes with a fairly normal income.

Once the zero-tax threshold is exceeded, marginal tax rates quickly become punitive, and even those with moderate incomes face huge disincentives for additional work effort. Figure 2 shows the marginal tax rate paid at various income levels in Sweden, as stipulated by the tax code, before individual deductions. The curve has two kinks. The first one appears just above \$42,000 and represents the first national income tax bracket, adding a 20 percent tax to the flat regional-local income tax. The second kink, at \$59,800, represents the second, 25 percent bracket.

Most Swedish professionals are within national income tax

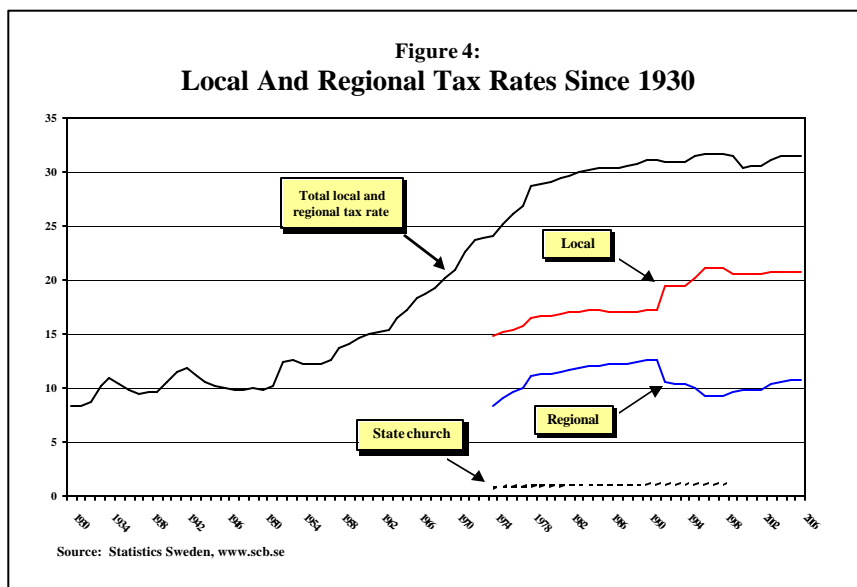


13 Income exemption in the Swedish tax system is based on a sliding scale. Beyond SEK 16,600, the exempt income falls as a share of the annual taxable income, up to the cap of SEK 300,000 (\$41,173). A person at that income level is eligible to exempt a total of 3.9 percent of his income, or SEK 11,600 (\$1,592). In other words: the personal exemption shrinks as income rises – a clear indication of a strongly redistributive income tax.

territory. Almost half of all employees in Sweden pay national income tax and therefore experience a marginal income tax rate of about 50 percent.

These high marginal income tax rates are noteworthy since the 1991 tax reform aimed at reducing the labor supply disincentives from high marginal taxes. The 1991 tax reform itself was long overdue (see Figure 3). A public fury over the excessive income taxes broke out in the 1970s, when the internationally renowned children's book author Astrid Lindgren penned a satiric anti-tax essay. She ridiculed a tax system that allegedly exacted a 102 percent marginal income tax on her earnings and initiated a debate that many economists had vainly tried to instigate from the academic side.

Through the '80s there were some adjustments to the income tax law in order to remove the most severe marginal effects, but it was not until the 1991 reform that radical changes were brought about. Only two income tax brackets were left in place: the flat local-regional tax of about 30 percent and a 20 percent national tax rate on the wealthiest 10 percent of the population. The authors of the reform explicitly wanted to protect 90 percent of the population from national tax, as they saw low marginal taxes as critical to fostering economic growth.



It did not take long, however, for politicians to increase the number of taxpayers hit by the national tax. A year after the reform, the top income quintile were paying the maximum tax rate. This trend continued, and today almost half of all taxpayers pay national income tax on top of their local taxes.

To make matters worse, in 1995 the legislature introduced a third, 25 percent, tax bracket. By some estimates, one-fifth of the work force is now in the top income tax bracket where they, on average, face a marginal tax rate of 56.5 percent.

Capital income tax: Interestingly, Sweden implemented a 30 percent national flat tax on individual savings and investment income as part of the 1991 tax reform. At the time, a 30 percent national tax on capital income was roughly akin to the local/regional tax on labor income. This meant that 90 percent of the population – the ones who did not have to pay the national government's 20 percent income tax – was subject to tax rates of about 30 percent on all forms of income and changes in net worth.

It would be grossly inaccurate, though, to assert that Sweden was close to a flat tax. One of the key principles of the flat tax is that income is taxed only one time. This means that there should

be no additional layer of tax on savings and investment income – assuming, of course, that individuals are saving and investing after-tax income. In other words, if a worker earns money, pays tax on that money, and then deposits money in the bank or buys a stock, there should be no additional layer of tax on the individual if that money generates a return.

Payroll tax: The payroll tax rate in Sweden is nearly 40 percent. Most of this onerous burden – 32.28 percent – is paid by employers, with employees bearing a payroll tax of at first 7 percent, now 10 percent. The distinction between “employee-paid” and “employer-paid” is artificial, however, since labor economists are in broad agreement that the tax is really borne by workers in the form of less take-home pay. If a company thinks a worker will generate \$50,000 of revenue, for instance, it certainly will not pay him more than that amount. And if the government insists that the company pay \$10,000 of payroll tax, the worker’s take-home pay will not exceed \$40,000.

In the case of Sweden, the 32.28 percent “employer share” of the payroll tax means that a worker will receive gross pay of only \$67.72 for every \$100 of employer cost. But this high tax rate is just part of the story. A Swedish worker then has to pay the “employee share” of the payroll tax, along with national, regional, and local income taxes. For a reasonably well-compensated worker, the marginal tax rate on the \$67.72 gross pay can exceed 60 percent. This means that a worker may receive less than \$30 of after-tax income for every \$100 of labor compensation – a tax wedge of more than 70 percent.

The so-called employer share of the payroll tax is comprised of several elements, as outlined in Table 2.

Other important features of the Swedish system include the fact that these payroll taxes apply to all income. However, taxpayers generally do not “earn” benefits based on their total earnings and/or total tax liability. Indeed, the maximum social security benefit is about the level of average earnings. This is important since payroll taxes generally have imposed less economic

damage than income taxes precisely because workers received some benefit in exchange for the taxes paid. In other words, the payroll taxes can be seen – at least in part – as a form of “insurance premium,” albeit almost always with a poor rate-of-return and often with widely divergent effects on different demographic groups.

But if the traditional “social insurance” link between payment and benefits disappears, then the payroll tax ceases to be a “premium” and instead is a pure tax. As a result, it is appropriate to state that the real top marginal tax rate on workers in Sweden is more than 70 percent.

Table 2:
Components of the payroll tax

Retirement tax, employer share	10.21
Health insurance tax[1]	8.64
Labor market (unemployment) tax	4.45
Parental leave tax	2.2
Widow pension tax	1.7
Labor injury insurance tax	0.68
General Salary Tax	4.4
Total Payroll taxes	32.28

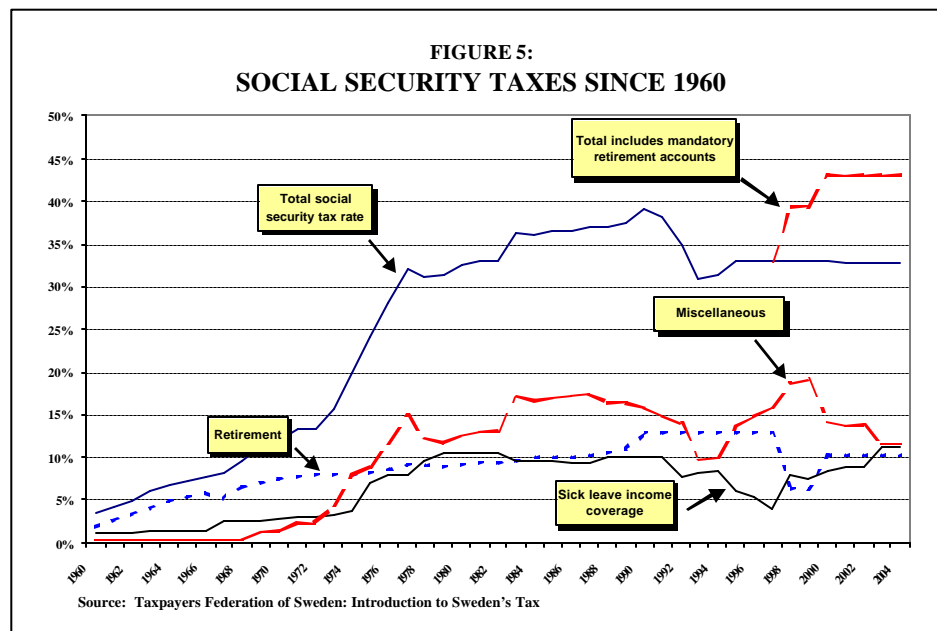
Source: <http://skatteverket.se/infotext/arbetsgivare/socialavgifter.4.18e1b10334ebe8bc80005862.html>

But there are some attractive features of the Swedish payroll tax system, most notably the fact that part of the payroll tax – 2.5 percent – goes into a personal retirement account. Moreover, the government-run portion of the retirement system has been changed to “notional” defined contribution accounts, meaning workers get retirement benefits in direct proportion to the amount of payroll tax they pay. As noted in the earlier analysis, this minimizes the “tax” effect and maximizes the “premium” effect of the payroll tax.

The net effect of these provisions is that payroll tax rates are very akin to an income tax for upper-income workers. For workers with more modest incomes, by contrast, a portion of the payroll tax can be viewed as a form of deferred compensation and thus the economic disincentives are much reduced. The overall system certainly is not conducive to growth, though, particularly since – as shown in the chart – the payroll tax burden has risen dramatically.

Wealth tax: In addition to taxing labor income and double-taxing capital income, Sweden also has a wealth tax. All wealth up to SEK 1.5 million (\$205,863) for singles and SEK 3 million (\$411,726) for couples is tax exempt. The tax rate is 1.5 percent of the total net worth above the exempt value, and includes homes, cars, and most financial assets¹⁴

Taxing wealth has severe economic consequences. It tends to drive capital to other jurisdictions, thus depriving an economy of the saving and investment needed for future growth. While it is inherently difficult to pinpoint the impact, the National Federation of Employers has estimated that SEK 974bn, about \$134bn, is sheltered abroad to avoid the wealth tax.¹⁵



14 Detached, single family properties and townhouses are taxed at their net market value. Co-ops, on the other hand, are counted as wealth according to the net value of the owner's share in the co-op association. Unlike other forms of capital, money in individual retirement savings accounts is tax-exempt. The reason is that the tax based public retirement system has suffered from the same under-funding problems as the U.S. Social Security system. A reform of the retirement system in the '90s added individual accounts to the system. Noticeable is also that cars worth SEK 10,000 or more (\$1,372) are taxable as wealth at their net worth. Stocks traded at the Stockholm Stock Exchange are declared as wealth at 80 percent of their net market value. Debt is treated in proportion to wealth, allowing tax deductions by “mirror images” of taxation on corresponding wealth.

15 April 1, 2006, Nyhetsbrev 24, by Björn Sunesson, 1 000 Miljarder Undanhålls Staten, Available at http://www.n24.se/dynamiskt/samhallsekonomi/did_12267262.asp

To the extent that capital does not flee, a wealth tax also is akin to higher income tax rates. Assume, for instance, that an investor earns a 5 percent return on capital. The effective tax rate on that return is going to be more than 50 percent. Thanks to the wealth tax, the 5 percent return is reduced by the 1.5 percent tax on the capital that generates the annual income. This is an effective marginal tax rate of 30 percent. But then the annual income is subject to the 30 percent national tax on capital income. It is the combination of these two taxes that determines the economic burden.

Small Business Tax: Owners of non-incorporated businesses such as proprietorships and partnerships are taxed on net income using the same tax rates that apply to labor income.

For partnerships, any income is assumed to “pass through” to the individual partners.

There are special rules for the payroll tax. A self-employed person is liable to pay those on a basis of the net business income – net of Social Security payments. This is achieved through a standardized deduction that is granted when computing the business income. The deduction is reconciled against the actual social security in the tax return of following year. Self-employed individuals have a slightly lower overall payroll tax burden, though they explicitly pay the tax while most other workers enjoy the illusion that the tax is paid by the employer.

Small businesses do endure high compliance costs, particularly compared to large corporations. Combined with high marginal tax rates, which reach 65 percent including payroll taxes, this makes it difficult for small companies to become big companies.

Corporate Income Tax: The corporate tax rate in Sweden is 28 percent, which represents a significant reduction compared to the 50 percent-plus tax rate that used to exist. Compared to other business entities, the tax system is relatively lenient on corporations. The tax rate is reasonably competitive by global and European standards, and the system is largely favorable for Swedish companies competing in global markets.

**Table 3:
Corporate tax rates in Sweden, 1970-2002**

	Statutory	Effective		Statutory	Effective	
1970	52.6	22.9		1987	57.1	22.6
1971	53.5	20.0		1988	57.1	24.0
1972	54.3	24.1		1989	57.4	20.0
1973	54.4	16.5		1990	47.8	22.0
1974	54.4	9.0		1991	30.0	22.0
1975	55.1	20.6		1992	30.0	28.1
1976	55.7	34.0		1993	30.0	30.0
1977	56.1	40.0		1994	28.0	30.0
1978	57.2	20.0		1995	28.0	30.0
1979	57.4	30.0		1996	28.0	30.0
1980	57.5	21.8		1997	28.0	30.0
1981	57.7	60.0		1998	28.0	30.0
1982	57.8	28.4		1999	28.0	30.0
1983	58.1	19.0		2000	28.0	30.0
1984	62.2	18.0		2001	28.0	30.0
1985	57.1	20.1		2002	28.0	30.0
1986	57.1	24.3				

Source: http://www.ratioinstitutet.nu/pdf/wp/gdr_kapitalskatter.pdf

**Table 4:
Effective Business Tax Rates**

China	45.8	Spain	27.3	Hungary	18.2
Canada	39.0	Norway	25.1	Czech Rep.	17.7
Brazil	38.5	Netherlands	25.0	Switzerland	17.0
<u>U.S.</u>	<u>37.7</u>	<u>India</u>	<u>24.3</u>	<u>Mexico</u>	<u>16.7</u>
Germany	36.9	Australia	24.1	Ireland	13.7
Italy	36.2	Finland	22.9	Portugal	13.5
Russia	34.5	Luxembourg	21.9	Iceland	12.1
<u>Japan</u>	<u>33.6</u>	<u>U.K.</u>	<u>21.7</u>	<u>Sweden</u>	<u>12.1</u>
France	33.3	Belgium	21.4	Slovak Rep.	9.1
Korea	30.8	Poland	20.2	Hong Kong	8.1
New Zealand	29.3	Denmark	19.8	Turkey	6.4
Greece	29.3	Austria	19.4	Singapore	6.2

Source: CD Howe Institute

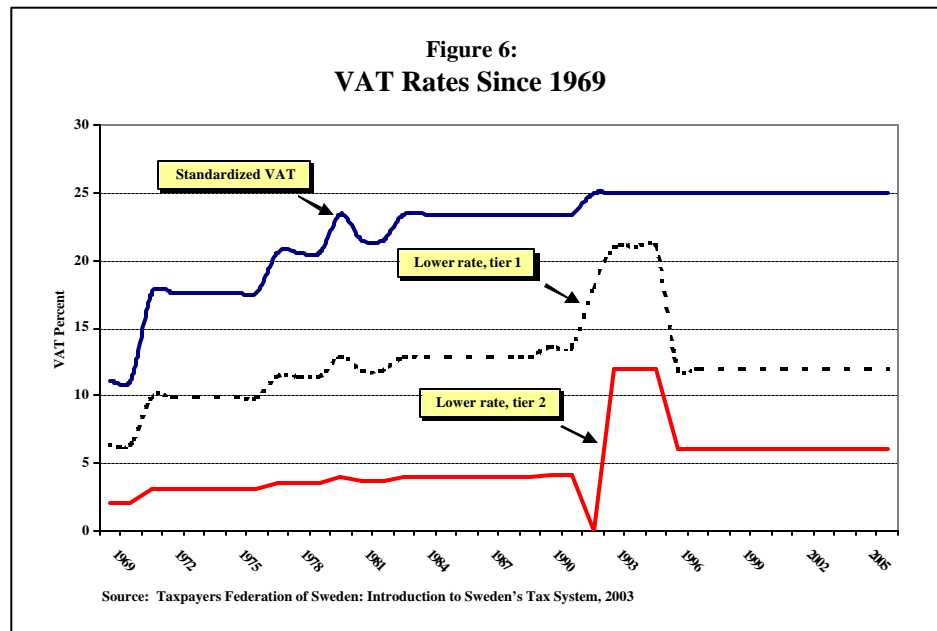
Indeed, by some measures, Sweden has one of the lowest effective tax rates on manufacturing in the world. The C.D. Howe Institute in Canada calculates that the average effective tax rate on manufacturing and services is just 12.1 percent.¹⁶ As Table 4 indicates, this is dramatically lower than most of the world's

nations. Moreover, the system is largely territorial, further enhancing the ability of Swedish companies to compete in global markets.

The Value Added Tax: Sweden has a value added tax, as is mandated by EU law. It is 25 percent on most private consumption. The VAT was expanded to cover a much wider range of goods and services as part of the 1991 tax reform. This was for two purposes – to finance lower income tax rates and to eliminate special preferences.

But just as the 1991 changes to the income tax proved fleeting, the same can be said about VAT reform. Changing VAT has been one of the Swedish legislature's most popular

activities over the past 13 years,¹⁷ which is one reason why the national tax agency's VAT regulatory document is 1,050 pages long. Approximately 17 percent of private consumption is



¹⁶ http://www.cdhowe.org/pdf/commentary_216.pdf

¹⁷ Only one year after the 1991 tax reform, the VAT was cut from 25 percent to 18 percent on hotel nights, restaurant services, groceries and public transportation. After a year under VAT, some health and social services were relieved entirely of value added taxes. A year later, the 18 percent VAT rate was raised to 21 percent, with the exception of public transit and hotel services, where VAT was cut to 12 percent. Letters sent through mail were burdened with a 12 percent VAT. In 1994, anyone who sub-let offices or apartments was required to pay taxes. VAT on

taxed at a preferential 12 percent rate, and 27 percent is covered by an even more favorable 6 percent rate.

Lower rates apply to:

Food, hotels, camping, ski lift cards	12 percent
Works of art sold by the artist	12 percent
Newspapers, books and magazines	6 percent
Public transit, livery services	6 percent
Theatres, movies and concerts	6 percent
Zoological gardens, sports events	6 percent

Other Features of the Swedish Tax System:

1. *Degree of double taxation:* Sweden has “double-taxation” on some forms of income, which means that the effective marginal tax rate on some income is a combination of two or more taxes. For instance, after covering its costs and income tax, the corporation pays dividends to its shareholders. They, in turn, pay a national 30 percent income tax on those dividends. Moreover, the wealth tax imposes a 1.5 percent tax on 80 percent of the net market value of stocks.
2. *Special preferences:* There are not many special preferences in the Swedish tax system. All sectors, all economic agents, are burdened with highly excessive taxes. If anything, though, the gradual drift upward in marginal income taxes has come to give an indirect special preference to part time employment and discouraged education and other professional development activities.
3. *Treatment of Capital Investment:* Sweden, like most nations, does not permit businesses to properly deduct business investment costs in the year they occur. Instead, businesses are forced to pretend that substantial portions of the cost do not occur until future years, a policy known as depreciation. Businesses are allowed to “depreciate” equipment according to the following rules:
 - Immediate deductions – or expensing – are allowed for machinery and equipment with a normal lifespan of no more than three years, or for minor investment expenditures.
 - Longer-lived durables, including structures, are depreciated according to an “accounting based” principle or based on “remaining value”. In other words, if a machine is expected to last 20 years, the tax code would force a company to deduct

groceries was lowered to 12 percent in 1996. Newspaper VAT was lowered to 6 percent. In 1998, local social agencies were allowed to provide apartments to people with specific disabilities without the tenants having to pay VAT to the national government. A year later pharmaceutical services were exempt from VAT, as were services by some other certified health care professionals. After the turn of the millennium, undertakers could once again operate without having to charge VAT for their services. In 2001 the VAT on visits to zoological gardens was cut to 6 percent. A year later, books and magazines were included under the 6 percent VAT rate.

that cost over that period rather than the year when the cost is incurred. Oftentimes, however, the tax treatment is not that onerous.¹⁸

- So-called intangible assets such as trademarks and “goodwill” can be depreciated, with the rates governed by various laws.

The 1991 Tax Reform

During the post-World War II period, Sweden imposed increasingly high tax rates on personal and corporate income. The top tax rate on individuals topped out at 87 percent in 1979 and the top tax rates on corporations was 52 percent. Combined with a rising burden of government spending, this fiscal policy undermined economic performance. Real GDP growth in Sweden during the 1980s was sluggish, averaging just 2.2 percent per year. Combined with other signs of economic weakness, this led the government to implement a sweeping tax reform in 1991.

The 1991 legislation improved the overall structure of Sweden’s tax system, including lower tax rates on personal and corporate income – as well as a flat tax on capital income. This reform, however, was not enough to prevent a deep recession from 1991 to 1993. Unemployment rose from 1.7 percent to 11.6 percent in less than two years, and stayed at double-digit levels through 1997.¹⁹ This downturn caused a significant reduction in the tax base. Fewer jobs and lower incomes meant less money for the government. Tax revenues actually fell as share of GDP during the economic downturn.²⁰ This led to budget panic in the legislature. Instead of taking the opportunity to reduce the public sector, legislators frantically worked to regain lost revenues. Many pro-growth options were shelved or curtailed. Nonetheless, the tax system after the watering-down of the reforms certainly was better than the tax system that existed in the 1980s. Indeed, growth returned and real GDP grew by 2.55 percent per year between ’93 and ’02.

4. *Complexity*: The complexity of the Swedish tax system is, in part, a result of its massive presence in the economy and the existence of many taxes. But some forms of taxation are particularly complex. The Swedish Tax Agency’s 1,050 page long VAT regulatory document, for instance, is a testimony to the complexity of the tax system.

Swedish law is divided into an odd pair of regulatory instruments: formal, regular law and “recommendations.” The latter is also referred to as “framework law,” and it consists of law-style paragraphs that indicate the government’s “desire” of course of action that businesses, e.g., should take. Munnich estimates that the business sector in Sweden has to comply with about 7,000 regulatory instruments, a third of which are “recommendations.”²¹ The regulatory burden has increased dramatically since the tax reform, which effectively constitutes a re-regulation of the business sector.

18 <http://skatteverket.se/svarpavanligafragor/foretagbalansposter/foretagbalansposterfaq/5.18e1b10334ebe8bc8000117864.html>

19 <http://www.konj.se/download/18.2b06ad4d10823916e6d80003524/am02.xls>

20 Statistics Sweden, www.scb.se, national accounts and public finance data.

21 Munnich, Miriam: The regulatory burden and administrative compliance costs for companies; A survey by the Confederation of Swedish Enterprise, Brussels Office, April 2004.

WHY THE TAX SYSTEM IS GOOD

Sweden's tax system has few virtues, but they are worth noting. It was reformed, generally with good intentions, back in 1991, but a relentless search for more tax revenue has since then created a patchwork of different tax rates and costly regulations. But at least marginal income tax rates today are still lower than they were in the 1980s. The strongest aspect of the system is its relatively lenient treatment of large corporations – if they were taxed and regulated the way small businesses are, Sweden would rapidly lose even more jobs abroad than it already has.

It is also relatively easy to earn capital income in Sweden, and the local and regional income taxes are transparent. However, they are all at very high levels and it is important to remember that the services provided by local and regional governments are also financed by a number of co-pays. In health care, e.g., these co-pays can easily cover the operational cost of a government-run local clinic, while all patients also pay 12-13 percent income tax to cover the cost of the very same health services.

WHY THE TAX SYSTEM IS BAD

Simply stated, the aggregate tax burden in Sweden is too high and marginal tax rates on productive behavior are very onerous. The high tax burden finances a costly public sector that misallocates capital and labor. The high tax rates discourage work, saving, and investment. The result is that Swedish economic performance is sluggish. Real growth has remained below 3 percent per year, on average, for most of the time since Sweden's tax burden reached record levels in the late 1970s.

- One significant problem with this sustained track record of sluggish growth is that it gradually eroded the tax base for the country's pay-as-you-go retirement system. The situation grew so critical over the '80s that the socialist dominated legislature introduced widespread private retirement accounts in the mid-

**Table 5:
Employment rate in the Swedish work force**

Year	Employment rate	Not in work force
1987	80.5	13.5
1988	81.3	13.1
1989	81.8	12.7
1990	82.2	12.3
1991	80.1	13.0
1992	75.6	14.6
1993	70.0	16.6
1994	68.4	18.1
1995	69.1	17.8
1996	68.7	18.1
1997	68.0	19.1
1998	68.9	19.6
1999	70.1	19.0
2000	71.5	18.5
2001	72.8	18.1
2002	72.7	18.3
2003	72.4	18.1
2004	71.7	18.2

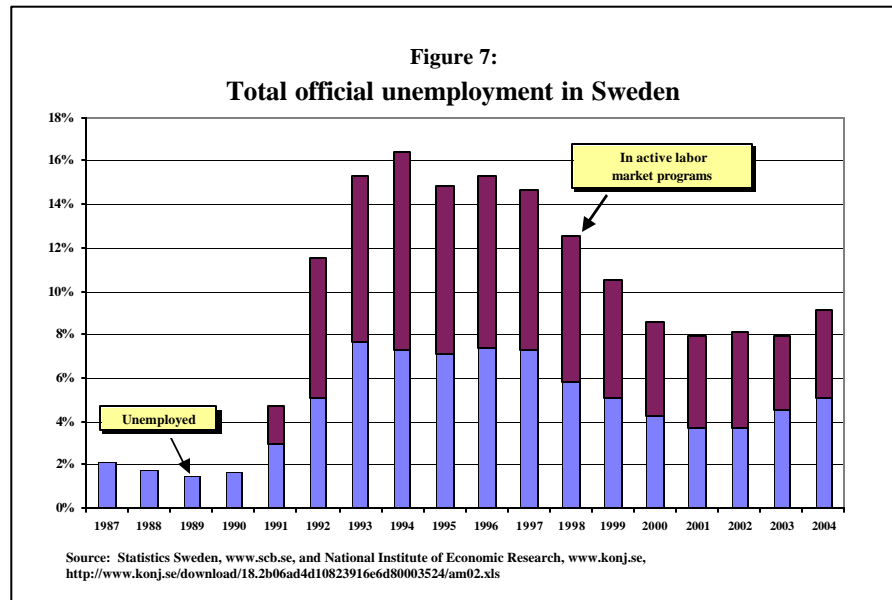
Source: Statistics Sweden, Labor Market Survey:

<http://www.ssd.scb.se/databaser/makro/Produkt.asp?produktid=AM0401>

1990s.

- Although the official unemployment rate is now above 8 percent, the employment rate (those employed as a share of the working age population) has not changed since the days of double digit unemployment. As seen in Table 5, the average employment rate over the past decade is 70.5 percent. The share of 20-64 year olds choosing to drop out of the work force has been equally stable, averaging 18.5 percent over the same period.

- It is not easy to determine the true level of unemployment in Sweden. Official accounts places it in the lower end of the EU, but one has to keep in mind that Sweden has a long history of so called active labor market programs. It is highly contested whether or not these programs generate employment for their enrollees and whether or not they have any effect at all on the labor market itself.²²



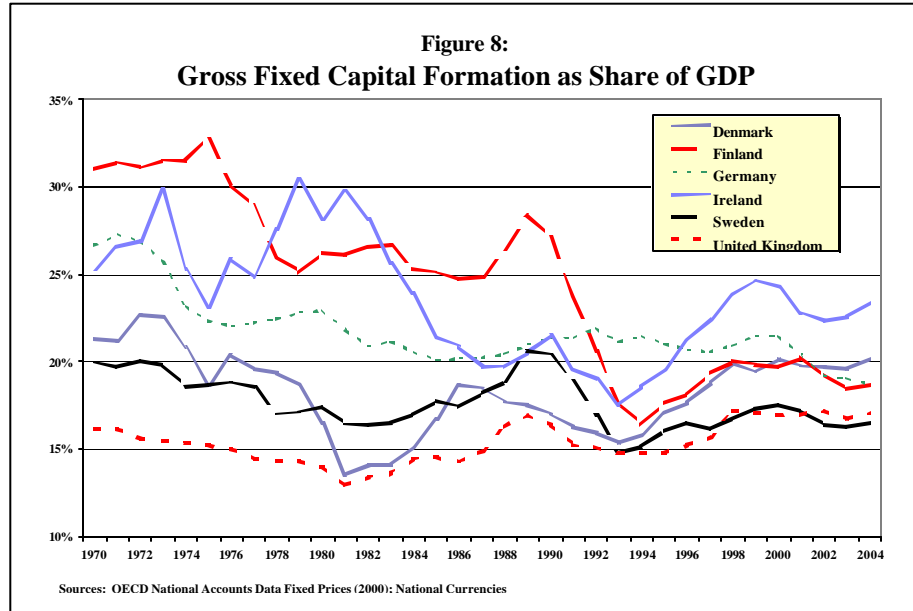
- Estimates usually put total Swedish unemployment, including the so called hidden unemployment, at somewhere between 15 and 20 percent, about three times above the official unemployment figures. The debate over Sweden’s true unemployment situation has not yet spilled over into English speaking publications, except for argumentative presentations on private blogs run by economists or policy analysts. The most spectacular statement in Swedish regarding Sweden’s real unemployment situation was made by Mr. Hans Karlsson, a member of the prime minister’s cabinet as secretary of labor. In 2005 he was quoted²³ in Dagens Industri, a major business daily, as saying that about 20 to 25 percent of the work force is unemployed and that most of them are “stashed away” in the statistics on long term sick leave, in labor market programs, or in early retirement and similar programs. This statement is all the more remarkable since Mr. Karlsson, prior to becoming a cabinet member, was a senior staffer at the corporate policy unit at Sweden’s national federation of labor unions, LO.

22 One of the most comprehensive studies on this was published by the Institute for Labor Market Evaluation in Uppsala, Sweden in 2002: <http://www.ifau.se/upload/pdf/se/2002/wp02-04.pdf>

23 <http://di.se/Nyheter/?page=%2fAvdelningar%2fArtikel.aspx%3fArticleID%3d2005%5c03%5c16%5c137054%26words%3dhans%2ckarlsson>

- Gross fixed capital formation is a good indicator of the legal and economic environment

for businesses in a country. By and large, the higher its share of GDP, the more confidence that investors have for profitable operations in a country. Figure 8 reveals a steady decline in investments in European economies since 1970. The select group, which is



representative of both big and small European countries, also places Sweden in an interesting context: from having been an average “investor,” Sweden has declined to bottom rank among this peer group. During the same period of time, Sweden’s taxes have increased to record levels and now rank as the most onerous in the world.

- High taxes and excessive regulations have encouraged many large corporations to leave the country. Almost the entire pharmaceutical industry has moved: the most significant examples are Pharmacia, which was bought by Michigan-based Upjohn, and Astra, which was effectively taken over by Zeneca. Research and development has moved abroad, while some low tech production has remained in Sweden. The automobile industry met a similar fate in the 1990s: Volvo Cars was broken out of the Volvo Corporation and sold to Ford; GM took over SAAB Automobile. SAAB is already building two of its four models for the American market outside Sweden and Volvo has expanded its Netherlands and Belgium operations significantly.
- IKEA and TetraPak also moved abroad. IKEA was founded by Mr. Ingvar Kamprad soon after World War II. Having become one of the world’s richest men on low price, “self assembly” furniture, Mr. Kamprad has relocated his corporation to the Netherlands. He himself resides in Switzerland.²⁴ The TetraPak Corporation, founded by the Rausing brothers, gave the world the “sausage stuffing” procedure for manufacturing and filling milk cartons. The technology made the brothers billionaires, and motivated them to relocate to England.²⁵
- By taxing professionals so onerously, the tax system also discourages education. This leads to a lack of highly skilled professionals and mounting recruitment problems in

24 <http://switzerland.isyours.com/e/about/dagblad.html>.

25 http://www.guardian.co.uk/uk_news/story/0,3604,682157,00.html.

sectors of the economy that are based on human capital. This shortage has not yet become a dire problem, but it soon will be. Between 1993 and 2000, emigration of college graduates grew by 48 percent. College graduates account for half or more of recent emigrants, with their share increasing slightly between '93 and 2000. Since then, emigration has continued to grow at 5-7 times the growth rate of the population as a whole, and anecdotal evidence from newspaper reports indicates that college graduates continue to dominate emigration.²⁶

FUTURE REFORMS FOR THE SWEDISH TAX REGIME

The 1991 reform had little lasting effect on the economy. Income taxes, business regulations and even VAT rates have been changed time and time again until it is virtually impossible to recognize any of the accomplishments of the reform. Another major tax reform is needed to restore the growth promoting features of the previous reform. However, it is somewhat pointless to try to reform a tax system that is also mandated to pay for one of the largest government sectors in the world. The prevailing climate in Sweden over the past three decades has favored larger government, a fact that is unlikely to change any time soon.

However, the costs of doing nothing are dire. Sweden has already today placed itself at the very bottom in terms of public sector efficiency. A 2003 study from the European Central Bank²⁷ shows that Sweden suffers from low levels of public sector efficiency, particularly when compared to other EU countries and the U.S. This inefficiency leads to higher taxes on households and businesses. Over the past two years local and regional income taxes have been increased in many parts of the country.

A sweeping tax reform that would bring taxes down to, say, Irish levels would require courageous efforts to reduce the burden of government. Privatization of health care and social insurance programs would make that possible, but there appears to be little interest in these reforms. The social democratic party, dominant in Swedish politics since 1932, is very unwilling to roll back government control over the economy. The incumbent Prime Minister, Goran Persson, has a long track record of protecting public sector revenues even at the cost of competitiveness and economic growth.

Heading into a general election, four moderate and conservative parties have forged an alliance to challenge the social democrats. Their platform promises little in terms of tax cut-promoting reductions in public spending. On the contrary, their agenda is to win the election by promising to preserve the Swedish welfare state. It remains to be seen whether this holds in reality – the Moderate Party (most market-oriented of the four) has a voter base with relatively strong preferences for limited government.

²⁶ http://www.scb.se/templates/Publikation___43461.asp.

²⁷ ECB Working Paper 2003:242, available at www.ecb.eu.int.

CONCLUSION

Sweden has a tax system that aims to redistribute and secure government revenues. Some of the key features of the 1991 tax reform are still present in today's tax system, but those that were put in there to encourage growth – such as lower tax rates on savings and income – are only vaguely identifiable.

The main problem in Sweden is not necessarily the corporate tax (although it is roughly twice as high as in Ireland, a corporate tax role model in Europe). Instead, the problem is that the government always seeks to change the tax system to preserve its revenues; by doing so, it tampers further with the market economy, undermines free enterprise and causes further loss of economic growth.

A case in point is the income tax, as illustrated by the continuous rise in the share of the work force burdened with high marginal taxes. Another example is the unfavorable taxation of small businesses. These counter-productive policies exist to protect government revenues – in order to fund the country's welfare state – and to redistribute income. Until Sweden's lawmakers are willing to forego a large welfare state, it is extremely difficult to reform the tax system in a pro-growth fashion.

The status quo is undeniably to the disadvantage of both the poor and the rich. It does not pay to pursue a professional career and earn more money. Nor does it pay to pursue a potentially profitable business idea. The Swedish federation of enterprises has often said that the current tax system forces small businesses to take imprudent risks – that is the only way they can make money. This in turn generates an unhealthy level of bankruptcies among small firms. A sound small business climate is essential to economic growth as well as job growth. Without that small business base, the Swedish economy faces a grim future.

Big government is Sweden's main problem. For all intents and purposes, it is impossible to have a tax system conducive to growth when government consumes more than one-half of economic output. To be sure, Sweden could ameliorate some of the worst features of the current tax system by reducing top marginal income tax rates. But such reforms merely make the best of a bad situation. Sweden needs to fundamentally re-think the welfare state and move to an economic system based on self-reliance and economic opportunity.

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