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Discussion Paper on Tax Policy and Tax Principles in Sweden, 1902-2016

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Contents

Abstract

The long time perspective on tax principles and tax policies in this discussion paper identifies some of the most important and relevant contexts for major Swedish tax reforms from 1902 until the present time. Until the 1991 tax reform principles played a significant role in tax law design. The relation between principles and legal concepts was quite consistent.

However, the 1991 tax reform seems to mark the end of a period when Swedish governments, with a certain regularity, initiated tax reforms to tackle contemporary economic and social challenges. In spite of several initiatives, proposed in well investigated study commission reports, no comprehensive tax reforms have been launched during a quarter of a decade. Instead hundreds of small, partial reforms have been implemented in tax law. Together with a new budgetary framework these gradual changes have changed the overall revenue basis for the public sector and the welfare state. In tandem with this development, the policy discourse on taxing for economic growth has increasingly gained in influence.

Even though environmental sustainability, and later also fiscal sustainability, have been prominent in the design of the tax system, we also note that Swedish tax policy has potential to further integrate important economic and social sustainability goals such as gender equality, social inclusion and income distribution.

A result of the study is to show the complexity of a national agenda on tax policy. Legally enshrined goals and principles cannot easily be superseded with tax policies on a supra-national level, particularly if these policies are solely drawn from macroeconomic analysis on the mechanisms and trajectories of economic crises.

Keywords: Sweden, tax policy, tax principles, tax reform.

1. Introduction

Among other things, it is the objective of the Fair Tax project to produce ‘recommendations on how fair and sustainable taxation and social policy reforms can increase the economic stability of EU Member States, promote economic equality and security’ and ‘enhance coordination and harmonization of tax, social inclusion, environmental, legitimacy and compliance measures’. Against this background, it is relevant to identify some of the most important and relevant tax policy developments, challenges and contexts on the member-state level against which such measures as part of a conceptualized ‘fiscal EU’ would be planned, prepared and implemented. From a general perspective, such research may also function as a deeper and more detailed complement to the tax policy surveys of the Member States produced by the European Commission (for instance European Commission 2014, 2016b).

This paper examines tax principles and tax policies in Sweden during the period 1902-2016. It is noted that in recent decades, the Swedish tax system has changed considerably in the sense that it is less stable and less consistent regarding overall goals and policy ambitions than previously. The modern tax system that was created in the first decades of the twentieth century introduced progressive income taxes based on the ability-to-pay principle. Subsequently, the major tax reviews in 1938, 1947 and 1971 followed a recurring pattern. Tax principles were used as tools to help identify and shape the appropriate design of the tax system and what form it should take in order for long-term political goals, such as full employment or an expansion of social policy, to be achieved. The development of the tax system was thereafter characterized by periods of relative stability when it evolved according to the tax principles applied during the preceding tax reforms.

However, after the 1991 tax reform there was a divergence from that pattern. The tax system as it has evolved since has not been based on the tax principles established in the reform. We acknowledge that one important reason behind this was the economic crisis of the first part of the 1990s. The fiscal impact of this and the related macroeconomic policy shifts affected public finances to such an extent that many of the intentions concerning equity and redistribution in the 1991 tax reform had to be abandoned. However, this does not explain the extent of the adjustments in the tax system after the reform. In this regard, we note that one crucial difference between tax policy before and after the 1991 tax reform is that the emphasis on the long-term stability that characterized the Swedish tax system before the 1991 tax reform has been considerably undermined. In this respect, the direction taken by Swedish tax policy after 1991 bears a close resemblance to the shift in tax policy that has taken place in the OECD countries since 1980 (Steinmo 2003; Tanzi 1987). One explanation is that old taxes are not taken for granted to be 'good' taxes to the same extent as before. Instead, legislators and interest groups have gradually renegotiated the core elements of the reform through small changes and adjustments directed towards specific vested interests or short-term political goals in the form of budgetary adjustments, cuts in tax rates or abolition of taxes (cf. Buchanan 1987, 33).

Research into the history of the tax systems in the OECD countries during the twentieth century has noted that two major 'waves' in the evolution of tax systems, which are related to the general political, institutional and economic environment (Steinmo 2003; Piketty 2014; Lindert and Williamson 2016; Hacker and Pierson 2010). During the first decades of the twentieth century, progressive income and corporation taxation was introduced. These taxes were then institutionalized and made permanent as redistributive economic policies and the welfare state emerged during the interwar period. In the post-war period, this interpretation of tax as a policy instrument was consolidated and expanded as the state was given a key role in managing a regulated capitalist economy. However, from the 1980s politicians began to abandon the belief that taxes could be used effectively for both redistributive policy ends and as an instrument for managing the economy. Instead, tax policies were justified with reference to the goal of promoting economic growth and the role of free enterprise in the deregulated markets. This led to reforms and tax cuts which reduced the importance of equity as the widely accepted goal for tax policy (Steinmo 2003).

Following the account in Nerudova et al (2016, 12-15), one important aspect recognized in this paper is the fact that, even as sustainability issues and modifications of the traditional growth perspective have emerged as tangible policy alternatives during recent decades, this has not been accompanied by corresponding developments within tax policy. Instead, the growth perspective has been emphasized even more within tax policy since the 1991 tax reform than it was during the formation of the modern system. Even if the Brundtland Report, for instance, specifies that the sustainability concept should be based on the three interconnected pillars - economy, environment and society - very limited attempts have been made to integrate these issues in the overall design of the tax system. The introduction of a budgetary framework and environmental taxes as examples of fiscal sustainability and environmental sustainability, respectively, have been isolated issues with no consideration taken towards an overall sustainability policy. In this regard, it should also be noted that before 2015, no tax principle or any other policy guidelines existed which explicitly mentioned sustainable development as an overall objective of the tax system (Government bill 2014/15:100, 104).

As in the other OECD countries, Swedish tax policy has been strongly influenced by the increased and deepening economic integration that has characterized the world economy since the 1970s. Against this background, we have chosen to relate our analysis of the 1991 tax reform to previous research on the impact and implementation of the tax reforms in other OECD countries. This research builds on an initial common globalization thesis which suggests that the capacity of mobile asset holders to move investments across national borders forced governments to compete for investments. Effectively, this means that governments are forced to progressively lower taxes on mobile assets, creating a so-called 'race to the bottom' in the process (Swank 2006, 851). Later research has been directed towards disproving this race-to-the-bottom hypothesis. It has been noted that even while there is no doubt that international tax competition influences national tax policies, tax policy is still dominated by the political objectives of maintaining a balanced budget and meeting societal demands for tax equity (Plümper, Troeger and Winner 2009; Swank and Steinmo 2002).

In Sweden the shift towards adaptation to market conditions leading to an increase of tax competition has been manifested through small but gradual changes, inevitably driving the tax system in a certain direction. In this regard, the Swedish tax system since the 1991 tax reform has followed a pattern which sociologist Stefan Svallfors describes as 'under-the-radar politics'. These are processes that are not visible even to many actors and organizations in society, and are completely invisible and unintelligible to the average taxpayer (Svallfors 2016). Nevertheless, the combined effect of all such gradual adjustments has been a slow, but crucial, transformation of the tax system which has changed the overall revenue basis for the public sector and the welfare state.

2. The Swedish doctrine of tax principles. A twilight zone between legal principles and tax policy norms.

The ambition of this section is to clarify how normative principles regarding fiscal sustainability and tax fairness have been applied in the drafting of tax law, as an introduction to the empirical account of the historical development of the tax system. In the definition of normative principles we have excluded the constitutional principles of legality and transparency, which are central for all types of regulations.

In Nordic tax law scholarship, tax principles have been part of a theoretical doctrine concerning what constitutes a sustainable and fair tax system. Principles have mostly served as objectives and normative tools for achieving coherence in tax law design; Swedish tax law doctrine, however, has debated the twilight zone between legal and tax policy normativity. In the dogmatic tradition policy normativity has long been regarded as outside the scope of legal research (SkatteNytt 1998). The tax principles have served as important instruments in the drafting of tax law, and have played a central role in the long history of a broad political representation in Government committees which carry out the most important part of the preparatory work for a proposed law reform. Preparatory work is published and well elaborated, and recognized in doctrine as a source of interpretation for legal practice. Courts and public administration frequently use preparatory works as sources for interpretation (Persson Österman 1997, 65; Lindencrona 2007, 164-167). Even though domestic Swedish tax doctrines are challenged by the influences of globalization and supranational treaties, as discussed later in the text, the self-image and the history of tax law drafting should be understood in the light of the influence of preparatory work in Swedish legal culture.

The ability-to-pay principle originally emerged from the philosophical idea of the state as a social organism based on a mutual dependency between the state and the individual citizen. It is a principle built on the ethics of distributive justice, and is deeply anchored in both Swedish and international tax law doctrine. At its core, the measurement of individual taxpaying capacity should be equal to the amount or degree of private means that the taxpaying citizens can achieve. In tax theory, as well as in tax policy, the principle has been interpreted in two ways; one equality-oriented, implying equality of treatment and horizontal equality, the other oriented towards the financing of the welfare state and the concept of social justice, and vertical equality by levelling out incomes and wealth. In practice the ability-to-pay principle has served as a basic policy norm for the design of income and wealth taxation, and has also partly been used for implementation through the introduction of progressive tax schedules where the taxed amount for an individual has increased with the amount of taxable income, The Haig-Simons theoretical concept of income fits best with the ability-to-pay-principle, and also advocates a broad-base income tax. In short the concept states that income should reflect the net accretion of a tax payer's power to consume over some period of time, without distinctions as to source or use. Another concept that has been influenced by the principle is global taxation, under which all income from whatever source is aggregated and one scheduled rate is applied (Gunnarsson 1995, 125-129; 1998 and 1999).

The idea of tax principles regarding neutrality is rather complex as it needs to be bench-marked in one way or another when it relates to economic efficiency. One definition of neutrality that has had an impact on tax law drafting in the Swedish context requires a distinction to be made between neutrality as equality of treatment, neutrality as uniformity of regulations, and neutrality as non-distortion of economic decisions. If the objective is to avoid undesired tax-induced distortions in economic decisions made by companies or individuals, neutrality has to be derived from a kind of perfect market situation (Mutén 1966, 48; Gunnarsson 1998). The norm that economic decisions should be unaffected or only minimally affected by tax factors has been used as synonymous for the achievement of a 'level playing field', meaning that one group of tax payers is neither advantaged nor disadvantaged as a result of the tax system. In Sweden, neutrality in practice overlaps with horizontal equity - the equitable tax treatment of persons with the same level of income/or capital but who differ in other relevant aspects (cf. Messere, de Kam and Heady 2003, 225). In order to distinguish the principle of horizontal equity from the principle of uniformity, a principle of neutrality of inefficient distortions would probably have provided a more clarifying concept, as would a concept recognizing the normative concerns that have occurred in practice.

Optimal taxation for economic growth is a bench mark for distributive neutrality, also called fiscal taxation, as the purpose is only to raise revenue. Tax rules that deviate from this neutrality concept are regarded as distortive tax expenditures (Harvey 1936; Hayek 1956; Mattsson 1992). This version of neutrality has developed a principle of fiscal taxation.

Finally, tax neutrality, particularly the principle of competitive neutrality promoting neutrality in all chains from production to consumption of goods and services, has been given the strongest position in the design of the VAT structure, promoting a broad tax and a single rate with no exemptions (Melz 1990, 67-77; Gunnarsson 1995, 255). In contrast to competitive neutrality, the neutrality principle based on optimal tax theory and Ramsey's rule on how to minimize excess burdens on the economy, promotes selectivity and differential rates (Gunnarsson 1995, 256-257).

3. The ability-to-pay principle and the creation of the modern tax system, 1900-1928

During the first decades of the twentieth century, progressive income and capital taxes were introduced. Taxes became an instrument for an economic redistributive policy and the tax system was designed according to the ability-to-pay principle (Gunnarsson 1995, 190-191; Kuylenstierna 1978, 519-520). The introduction of the ability-to-pay principle and the progressive income tax scale was part of a larger shift in revenue, where progressive direct taxes replaced the indirect taxes that had dominated the tax system during the 19th century. From the middle of the 1860s to the late 1890s, tariffs and other indirect taxes increased as a share of state revenues from 60 percent to nearly 90 percent. Low progression in the taxation of incomes and wealth, as well as the heavy dependence on mainly consumption taxation made the whole taxation system very regressive, hitting low- and middle-income groups the hardest (Schön 2010, 178-179). When direct income taxation was introduced in 1902 it linked the taxation directly to the individual person. This meant that greater attention was paid to a person´s ability to pay tax (Gunnarsson 1995, 165).

In this regard, the foundations were set by two decisions in parliament: the 1910 decision on state income tax and the 1928 decision on municipal income tax (Government bill 88/1910; Government bill 213/1928; Government bill 214/1928). One crucial part of this process was to define the sources on which income taxation should be based. This led to an intense debate regarding the income concept during the preparation for the municipal tax (SOU 1923:70). However, both taxes were based on the global model for income tax. It was established that personal income tax should be levied on real net income. Based on the source theory about sustainable income, a pluralistic income concept was developed separating income from various sources such as property, business, farming, waged work and regular income from capital. An income tax base for capital, in line with the Haig-Simons income concept, was not realized as capital gains and other capital incomes of a less regular nature, or not defined as income in relation to the national income definition, were excluded (Gunnarsson 1995, 160-162).

One important result of the 1928 municipal tax legislation was that it established intermunicipal equity as one of the tax policy principles (Andersson 1995, 319-324). The foundation for Swedish fiscal federalism in this regard is the intermunicipal equalisation system (*det kommunalekonomiska utjämningssystemet*). Through this system, some municipalities are obliged to transfer part of their revenue to other municipalities which cannot levy sufficient public revenue to maintain the national standard for mandatory municipal services such as education and child care (Chernick 2004, 79-80).

4. Public expenditures, full employment and the formation of the welfare state, 1932-1947

The Social Democrats were in office from 1932-1976, meaning that their tax policy had a crucial impact on the design of the tax system. The Social Democrats combined the ability-to-pay principle with an active and interventionist economic policy which aimed at full employment and redistribution within the welfare state. One early example of the application of the ability-to-pay principle was the inheritance and gift tax reform in 1933. During the first decades of the twentieth century, tax rates were practically flat and very low (Silfverberg 2001). However, from 1934 onwards the Social Democratic government increased the inheritance and gift tax rates, thus changing the role of the inheritance and gift tax as a fiscal instrument. This change was strongly linked to the emerging Social Democratic macroeconomic policy (Government bill 34/1933). In contrast to the party program of 1920, which comprised a radical socialist economic policy, including nationalization of parts of the private sector and other similar steps to restructure the economy, the economic policy after the Social Democrats returned to office in 1932 was focused on countercyclical policy (Benner 1997, 79).

Motivating the increased inheritance and gift tax, the finance minister Ernst Wigforss argued that more revenue was needed to deal with effects of the economic downturn that had followed the outbreak of the Great Depression in 1929. Since revenue lagged behind economic growth, tax increases had become necessary. Wigforss noted that while part of the increased tax burden had already been met through increases in income taxes and consumption taxes, a rise in inheritance and gift taxation was also necessary. He therefore argued that well-to-do or very wealthy citizens should share part of the increased tax burden that was necessitated by the crisis (Government bill 34/1933, 40).

Accordingly, Wigforss argued that the inheritance and gift tax taxation should be based on a progressive scale where the taxed amount for the heir increased with the size of the inherited wealth (Government bill 34/1933). In practice, this meant that while there was a general increase in taxation for all groups, the tax rates for those in the highest brackets increased more than for those in the lowest bracket. Even if these effects were not expressed in clear quantitative terms, some indicators of the nature of the reform were given. It was stated that while the reform was expected to increase overall revenue from the inheritance taxes by 50 percent, the increase in the rates for heirs in the highest bracket, such as spouses and children, would be more than doubled (Swedish Parliament, Special Committee Statement 23/1933).

The ability-to-pay principle also became the foundation for the first post-war tax review, where it was combined with a social policy principle. As background to the review, Wigforss summarized the main expenditure areas which had been expanding during this period. Apart from military expenditure, increasingly more tax revenue had also been channeled towards social policy, agricultural subsidies, expansion of education at different levels, including research and development facilities, and pensions. Wigforss noted that as this expansion of the public sector and the welfare state implied a continued need for tax revenue in the future, the existing tax bases needed to be expanded. Against this background, he stated that no taxpayer could expect a return to the previous tax levels. However, it was made clear that a substantial part of this new tax revenue would be collected from increased capital taxes and property taxes such as the wealth tax and the inheritance and gift tax. It was also inevitable that groups with high incomes would be subject to increased progressive taxation. Meanwhile, the tax level would remain relatively stable, or even decline slightly, for the groups with incomes in the lower brackets (Government bill 212/1947).

Regarding corporate tax, the period was dominated by the effects of a reform in 1938 which introduced the efficiency/interventionism principle as the foundation for this tax. It was designed as a bargain with business and industry as it meant that if businesses invested in places, times or activities that the government determined, taxes would be lower. If business owners chose to ignore those incentives, they would pay higher taxes (Steinmo 2003, 214).

This meant that a number of rules and arrangements were introduced which provided firms willing to invest with a number of tax-reducing depreciations. In the 1938 corporate tax legislation, new depreciation allowances for investments in machinery and buildings were introduced. Through these rules, investing firms could reduce their effective tax by writing off the entire cost of an investment in the same year that it was made (Government bill 258/1938). Accordingly, this new policy meant that the effective tax rate, as opposed to the statuary tax rate, could depend on the situation of the individual firm. For firms which invested, the effective tax rate could be substantially lower than the statuary tax rate (Bergström 1982).

The efficiency/interventionism principle was also applied to the so-called investment fund system which was introduced, together with the new corporate tax system, in 1938. The idea behind the investment funds was that, by writing off costs related to productive investments such as machinery, buildings and inventories, firms would be able to deposit some of their profits in an account in the central bank. These deposits were then exempted from taxation on condition that they were used for similar investments in periods of lower economic activity. The point in time when these funds could be released was to be decided by the government, to ensure that investments would be possible even during a downturn in the business cycle (Government bill 319/1938).

This design led to corporate taxation becoming one of the central institutions in the Social Democratic growth policy directed towards industrial transformation and full employment. Drawing inspiration from Eichengreen (2007), it might be argued that corporate taxation represented the 'capital' side of a post-war consensus agreement. However, its 'labor' counterpart was wage moderation created and maintained by institutions on the labor markets, rather than fiscal instruments such as income taxation, which followed the ability-to-pay principle in a consistent manner.

5. The 1960s: introducing VAT, upholding redistribution

In 1960, a general sales tax was introduced. On its introduction, the Social Democrats were aware that they needed to deal with the possibility that it might function as a regressive tax taking a higher percentage of tax revenue from those on low incomes. They wanted to avoid this as it violated the values behind the existing tax system, which favored a fair distribution of income through progressive direct taxes. In order to counteract such effects, the Social Democrats concluded that it was necessary to compensate lower-income groups for the regressive effects associated with indirect taxes through direct transfers (Government bill 162/1959, 67). In 1969, Sweden followed the pattern of most other Western European countries by replacing the general sales tax with a value-added tax (VAT) (Government bill 100/1968).

6. The 1971 tax reform: individual taxation, redistribution and social justice

The 1971 tax reform took the first step in the abolition of joint taxation launching the introduction of an individual income tax for spouses/marital units. It is interesting to notice that the ability-to-pay principle had been used for many years as an argument in favor of joint taxation. However, the quick shift to the opposite interpretation was strengthened by the objectives of tax equity and the need for an increase in labor market supply (Gunnarsson 2016, 7-8). When joint taxation was abolished for earned income in 1971 it not only served as a mechanism for improving equality of opportunity, but also as an additional incentive for working women (Government bill 70/1970; Gunnarsson 2013, 45-46). Individual taxation was later combined with other gender-equality instruments such as parental insurance and the expansion of public day care. Initially, the shift from joint to individual income taxation had a positive effect on the participation of married women in labor force. One study based on counterfactual micro simulations indicates that female employment would have been 10 percent lower in 1975 without the 1971 individual income tax reform. In 1974, the labor force participation rate among females aged 25 to 54 in Sweden was 70.3 percent, which corresponds to the 2007 OECD average level (for Sweden the same 2007 level was 87.1 percent) (Selin 2009). One estimate in a Government Commission report from 1977 also shows that the reform had a strong impact on the employment rate for women. During the period 1970-1975 the number of women in the labor force increased to around 200,000 women, of whom 50,000 had children under the age of 7 years. This trend was expected to continue, as it did (SOU 1977:91, 129).

The 1971 tax reform emphasized social justice not only through promoting gender equality but also, through interrelated measures, influencing the social policy principle. It is an example of the more radical policies that the Social Democrats introduced after the party congresses in 1967 and 1968. Curtailing the economic power and social status of wealthy groups and improving economic and social equality in a way that benefitted low-income groups now became an explicit goal (Government bill 70/1970, 68-70). One objective in the 1970 tax review was, therefore, to increase living standards for full-time employed workers on low incomes by reducing their income tax. This would strengthen the social justice and redistribution effects that had been produced by other welfare state and social policy measures. This ambition was also evident in the funding of the reform, which included an increase in the inheritance and gift tax, especially for the higher brackets, and a rise in VAT from 10 percent to 15 percent, which was covered by compensatory transfers to low-income groups (Government bill 70/1970).

7. Towards 'the wonderful night' in 1981

During the 1970s, a tax policy debate emerged centered on marginal taxes and the taxation of home-owners. Concerning the former, some observers argued that if the marginal taxes were too high it would affect incentives for affected groups on the labor market who would then abstain from working (SOU 1977:91, appendix 2). Furthermore, the design of the marginal tax also affected wages, where it added to all the other uncertainties in the period of stagflation after the 1973 oil crisis. Here, the core of the problem lay in the fact that, as the government wanted to reduce the income tax for lower brackets but not for higher brackets, they had to make up for this reduction by starting to raise the marginal rate even for the lower brackets in order to avoid giving the higher brackets a total reduction in taxes. Raising the marginal rate for one bracket meant that taxpayers who were in or just below the bracket had a smaller net increase after tax when their income rose. In turn, this meant that a greater increase in gross wages was needed in order to generate an equivalent improvement in their net wages after tax (Lodin 2011, 39-40).

In the first part of the 1980s, some elements of the marginal tax rules were reformed. A deal between the Liberal party, the Centre Party and the Social Democrats on a compromise made this reform possible (the Conservative Party left the center-right coalition government in protest against it). The reform reduced the national income tax and the marginal tax rate, particularly for those who earned between SEK 80,000 and SEK 130,000 (some brackets enjoyed reductions of up to 20 percent). The highest marginal rate was reduced to 80 percent for incomes over SEK 300,000 (Lodin 2011, 50; Ds B 1981:16). This agreement was coined 'the wonderful night' based on a spontaneous response by Rolf Wirtén, the Liberal Minister for the Budget, to a question during a press conference about how he viewed the negotiations with the Social Democrats which had taken place during the night between the 23 and 24 April 1981 (Lodin 2011, 50).

Regarding the taxation of home-owners, high marginal income tax rates and favorable deduction provisions introduced during the 1970s gave home-owners strong incentives to avoid taxes by incurring deductible costs and debt services. In particular, this applied to interest payments on housing. Interest payments on housing were fully deductible at the same time as inflation was high and interest rates on housing were subsidized through regulations. This meant that the real cost of housing was substantially reduced (Du Rietz, Johansson and Stenkula 2015, 19). For instance, in 1979 home-owners had been able to deduct 88 percent of the interest paid on their mortgage (SOU 2004:36, 87). In 1981, this issue was addressed through the afore-mentioned multi-party agreement during 'the wonderful night'. From 1982, the taxable value of capital income deficits (primarily related to interest deduction for homeowners) was limited to 50 percent (Lodin 2011, 50; Ds B 1981:16).

8. The 1991 tax reform

8.1. From global to dual income tax

In 1990, the Swedish tax system was comprehensively restructured. The reform redesigned the income tax structure by moving away from the source theory and the vertical-oriented part of the ability-to-pay principle which had been in place since 1910. The dual income tax combines progressive taxation of labor and transfer income with a relatively low proportional tax on capital income. This division of capital and labor income resembles a scheduler model in contrast to the global income tax model where personal income tax should be levied on the real net income - based on income from different types of property, business, work and capital, respectively (Gunnarsson 1995). The 1991 reform also repealed the previous company tax system. The flat capital income tax rate was set at 30 percent, in line with the corporate income tax rate, whereas the top marginal personal tax rate on labor income ended up at 51 percent. (SOU 1989:33; SOU 1989:35; Government bill 1989/90:110).

These cuts necessitated a substantial broadening of the VAT base to finance the costly marginal income tax reform, which brought the base much more closely into line with the sixth VAT directive on uniform basis of assessment (Council Directive 77/388/EEC). Before the tax reform, the Swedish VAT base was rather narrow but after it most of the previously untaxed consumption items became taxable, and all taxable consumption was subjected to the standard VAT rate of 25 percent (SOU 1989:35; Government bill 1989/90:111).

8.2. Nordic influences

To understand why Sweden shifted to a dual income tax system it is also important to put the 1991 reform into a Nordic context. The dual tax system is characteristic of the tax systems in Norway, Finland and Sweden. During the 1980s, the idea of a dual income tax system as the basis for tax reform spread among experts, academics and politicians in the Nordic countries (Sørensen 1994, 58-61). One important factor behind this collaboration was that institutionalized arrangements had been created for tax policy cooperation between the Nordic countries. During the post-war period, a number of recommendations from the Nordic Council urged the governments to establish contact and exchange information on taxation matters of common interest. Partly as a result of these recommendations, and partly on the initiative of the finance ministries, a very close contact was built up between experts, committees and officials in the Ministries. From 1964 onwards finance ministers had regular meetings. An official was appointed in each country as the main contact, and reports, draft legislation and other documents were exchanged regularly. Furthermore in 1973, on the recommendation of the Nordic Council, the governments created the Nordic Council for Tax Research to promote cooperation in this area (Wendt 1981, 180).

In Sweden, Gustav Lindencrona, professor of tax law at Stockholm University, became one of the first actors to launch the idea of a dual tax system as a possible alternative for tax reform (Lindencrona et al. 1986). The fact that Lindencrona was also an adviser to the Liberal Party meant that these ideas could become established on the political agenda (Folkpartiet 1987; Commission of Inquiry guideline 1987:29).

8.3. Distributional neutrality and tax horizontal equity

Neutrality and uniformity of taxation were the most prominent tax principles introduced in the 1991 tax reform. Subjecting all forms of income and consumption to tax at the standard rates strengthened horizontal equity, and in doing so, stopped the evasion of capital gains tax. It was also argued that the base-broadening measures of the tax reform promoted the goal of vertical equity, i.e., the principle that taxpayers with a greater ability to pay should foot a larger tax bill (Sørensen 2010, 69-70).

In this regard, it was noted that the existing income tax system was not only characterized by high tax rates, but also unequal treatment of various types of income. Income from capital was favored over income from employment, and non-cash benefits were favored over cash wages and salaries, while at the same time tax planning and tax evasion became more profitable than productive contributions. The unequal taxation of various types of income had caused macroeconomic distortions because people and companies were attracted to forms of work, organization and remuneration, as well as investment and financing alternatives, which they would not otherwise have chosen, only for tax reasons. The non-uniform taxation system also led to inequalities resulting from the fact that people with the same income paid different amounts of tax depending on their moral attitude and their knowledge and ability to use various methods to lower their tax. This problem with distortions and inequalities was accentuated by increasing international dependence and the deregulation of the credit market (SOU 1989:33, 31-32).

8.4. The dynamics of ‘taxing for growth’

It should also be noted that the debate on tax policy in Sweden had become affected by the general shift in the economic policy debate within the OECD countries towards liberal and market-based ideas. Although Sweden lagged behind in its general deregulation and liberalization of markets, the 1991 tax reform follows the pattern set in other OECD countries. The focus of tax policy certainly shifted from redistribution to growth, investment and ownership. The emerging neo-liberal ideas about the benefits of greater economic freedom that centered on individual disincentives produced by the tax system was used to criticize the existing tax system during the 1980s. Interest groups related to business and industry questioned whether Sweden would not in fact be better off if a more market-oriented, liberal system was introduced. Among those groups, there was a strong interest in dealing with what was perceived as outdated regulatory incentives which they saw as harmful not only to enterprise but also to the economy as a whole. One of the leading actors in this regard was the main business association - the Swedish Federation of Industries (*Sveriges Industriförbund*) (Lodin 2011, section 3).

There was also a greater political willingness to experiment with new concepts in public economics. During the 1980s liberal policy-makers, influenced by the neo-classical economics of incentives and labor supply, coined the concept ‘dynamic effects’ (*dynamiska effekter*). Supporters of dynamic effects argued that changes to a tax system, for instance cuts in the marginal rates of income tax, would not only lead to higher income tax revenue but also affect other tax bases in a positive way. This combined increased revenue would thereby make a tax reform, at least in part, self-funding (SOU 1989:33, 218-219).

9. After the 1991 tax reform

9.1. Loss of vertical equity

The reform was not intended to reduce the total revenue in relation to the GNP by more than a few percentage points, which was in opposition to the neo-liberal ideology governing the reform. Regulations that had redistributive motives directed towards vertical equity were excluded in the design of the 1991 income tax system. The idea was to leave the distribution policy undisturbed, in such a way that no income group should benefit or lose more in relation to other groups as an effect of the reform (Government bill 1989/90:110; Government bill 1989/90:140). Nevertheless, the extensive cuts in the state income tax levied on wage income were more beneficial for high and middle income earners. This meant that the reform was not neutral regarding distribution, and the tax shift to VAT to cover the revenue losses initially had a regressive effect for many low income households (Government bill 1989/90:110, 620-632; SOU 1995:104, 61-62, and 83-84).

There has also been a shift in income distribution. The period 1995-2012, saw an increasing difference in how real disposable income (inflation-adjusted income after taxes and social transfers) has increased between different percentiles. Growth for the whole period for P05 (the lowest 5 percent) is about 20 percent, which is lower than for the median, while that for P95 (the highest 5 percent) has increased 60 and 80 percent (Bengtsson, Edin and Holmlund 2014, 40-41). More specifically, it has also been noted that while differences in disposable incomes have increased since the mid-1990s, inequality with regard to factor incomes (incomes from labor and capital) has remained stable since 1994. In general, this indicates that the redistributive effects of taxes and social transfers have become increasingly weaker during the period (Bengtsson, Edin and Holmlund 2014, 44).

There is also long-term data which indicates that income distribution became less equal after 1995. In the period 1975-2010, income equality was strongest in 1980 and 1981. In 1980, the Gini coefficient for disposable income was 0.20, which might be compared to 0.24 around 1995 and around 0.33 in 2010. Relative poverty was also at its lowest in 1980/81 when the portion of the population with incomes below 50 percent of the median income was just above 4 percent. Around 1995, it was just above 6 percent. In 2009 it had risen markedly to 12 percent (Björklund and Jäntti 2011, 30-32).

One of the groups most affected by the economic and social changes in Sweden is families with children. The commitments to distributive neutrality between income groups made by the government in the 1991 tax reform were not met. Instead, the combined effects of poorly coordinated reforms in tax and social law made the tax/benefit interface as a whole more progressive, especially for low-income families. A personal social contribution was introduced at the same time as the tax bases for income taxes were broadened. This meant that allowable deductions from an income from employment were reduced leading to taxation of employees coming to resemble a gross income tax, rather than a net income tax. Benefits such as child and housing allowances and compensation levels for income losses due to sickness and parental leave were reduced. Municipalities also increased fees for public childcare. As a result, an increase in gross income led, at best, to a very modest increase in disposal income, and sometimes even to a decrease for low-income families (Gunnarsson 2003).

At the end of the 1990s, approximately one-quarter of children in Sweden lived in families with economic problems. About 120,000 children lived in families receiving long-term social assistance. Solo mothers were among the biggest losers when the general level of social security was cut in the 1990s. Even after the economic recovery at the end of the 1990s, solo mothers, who represented one-fifth of all families in Sweden, still constituted the highest percentage of social assistance recipients, 35.2 percent in 1990 and 32 percent in 1998 (Gunnarsson, Burman and Wennberg 2004, 157).

The reforms have brought about a functional division of tax law and social welfare law. Social welfare for families falls under social welfare law, whereas tax law is designed only to meet money-raising objectives. Such a functional division between tax law and social welfare law makes it easy to use different principles for income distribution in the two systems, meaning, in turn, that the two systems contradict each other (Gunnarsson, Burman and Wennberg 2004, 149).

In contrast to the 1971 income tax reform, the 1991 one reform did not express any concerns about gender equality. The focus was on cutting effective marginal tax rates on earned income. Those income earners with the highest incomes had the highest effective marginal tax rates, as the income-tax-rate scale had a redistributive, progressive profile. Unfortunately, during this process, the significant crossover effect between the marginal costs for women's paid work and the income of their husbands or partners (a gender-equality problem) was not taken into consideration. Not surprisingly, the cuts in the effective marginal tax rates had a moderating impact on women's paid work, as the marginal net of taxed salaries increased for men (Aronsson and Palme 1994). The shift from income tax to consumption tax also had a side effect that contributed to moderating women's labor supply. For the first time, a 25 percent value added tax (VAT) was introduced for several services that could be regarded as substitutes for the type of household maintenance that is traditionally carried out by women. It became more expensive for households to buy these services than for the women in households to perform those services themselves (Wennemo 1997, 18–19). As a result of this unfair outcome in gender equality terms, for substantially more women, particularly in the low income groups, the outcome of the 1991 tax reform was negative (SOU 1995:104).

9.2. The financial crisis of the public sector

The implementation of the tax reform was severely affected by the economic crisis that hit Sweden during the first part of the 1990s and the political changes that followed. While there is no doubt that the reform was well-designed and well-prepared, the outcome was very different from the intention. The restructuring of the public economy during the first part of the 1990s was aimed at reducing the budget deficit and fighting inflation. A price stability norm replaced Keynesian-influenced stimulus programs as the main target for economic policy (Government Bill 1990/91:39). At the same time, austerity policies were implemented to deal with public indebtedness. As a percentage of GDP, Sweden went from a public surplus of 5.4 percent in 1989 to a public deficit of 12.3 percent in 1993 (SOU 2000:83, 33). This situation was addressed by making heavy savings in public expenditure. Evidence of this is that for the four-year period 1995–98, public expenditure savings of 8 percent of GDP were undertaken (SOU 2000:83, 42-43). Other emergency measures to protect public finances included a 10 percent austerity tax (*värnskatt*) which raised the maximum marginal tax rate to 62 percent. This tax was introduced in 1994 as a temporary measure for five years. It was later made permanent but reduced to five percent (Lodin 2011, 111).

New legislated regulations for public finance were also introduced in the mid-1990s when a new budgetary framework was adopted. These comprise a surplus target for general government net lending, an expenditure ceiling for central government and the old-age pension system, together with a stringent central government budget process, and a requirement for local governments to balance their budgets (Swedish Government Office 2011, 5). There is a statutory requirement under the Budget Act (2011:203) for the government to propose a target, the surplus target, for general government net lending. The Swedish Parliament has decided that the surplus target is that net lending shall amount to 1 percent of GDP on average over a business cycle. The present level of the surplus target is to be maintained during the current term of office and for as long as is necessary to establish a sustainable long-term development of the public finances (Swedish Government Office 2011, 6). The Budget Act also requires the government to propose in the Budget Bill an expenditure ceiling for the third year to come. The Swedish Parliament decides the expenditure ceiling.

One important function of the expenditure ceiling is to provide conditions under which the surplus target can be achieved. The level of the ceiling should also promote a desirable long-term development of central government expenditures. Together with the surplus target, the expenditure ceiling guides the level of the total tax take and helps to prevent a development where the tax take has to be gradually increased as a result of insufficient control of expenditures. The practice is to include a budget margin of a certain size below the expenditure ceiling which functions as an initial buffer if economic developments cause expenditures to deviate from the original estimates (Swedish Government Office 2011, 6). New legislation with regulations governing public finance was also introduced in the mid-1990s when a new budgetary framework was adopted. Sweden's entry into the European Union from 1995 also created formal demands for fiscal sustainability. Apart from the demands produced by the national budgetary framework, Sweden has to follow the regulations regarding budget discipline defined by the Stability and Growth Pact (SGP) criteria. According to the SGP, Sweden may not have a budget deficit greater than 3 percent of GDP or a public deficit exceeding 60 percent of GDP (Government bill 2008/09:1, 88-89; SOU 2016:67, 35).

9.3. Tax neutrality at a crossroads

Tax policy principles such as neutrality, horizontal equity and uniformity of taxation have lost in influence since the 1991 tax reform. Instead, politicians prefer to differentiate rates through the introduction of tax expenditures, which have counteracted the intentions of the 1991 tax reform. The treatment of VAT rates is one example of this. According to Peter Birch Sørensen, policy makers have experimented with new tax designs and selective tax cuts in their efforts to promote employment and entrepreneurship. As a result, the new VAT regime already began to unravel at the beginning of 1992 and has continued to do so up to the present. In this regard, politicians have tried to strike a balance between competing goals such as the desire to stabilize the economy, the need to protect government revenue, and the wish to ensure that the burden of the crisis was shared fairly. As part of their crisis management, politicians resorted to a differentiated VAT. As their emphasis on the various policy goals shifted back and forth over time, the result was numerous changes in VAT legislation (Sørensen 2010, 91-93). Even if arguments and proposals for a return to a uniform VAT level in an adjusted form have been aired they have not gained political support (SOU 2005:57; SOU 2006:90).

In this regard, the Swedish National Audit Office has raised the question the extent to which uniformity as a guiding tax principle has been replaced by an optimal taxation approach

(Swedish National Audit Office 2010). In 2010, the government initiated a discussion on tax expenditure where optimal taxation was discussed in relation to the principle of uniformity. Here, the government noted that one motive behind tax expenditures could be to improve socio-economic efficiency as societal resources are redirected to optimize social welfare. The government could not exclude the possibility that the tax system distorted the societal resource allocation through market failures or tax wedges which caused deadweight losses and by changing this resource allocation, socioeconomic efficiency would improve. From this perspective, the government concluded that deviations from uniform taxation could be motivated if this improved socioeconomic efficiency and welfare in society. If uniform taxation led to a deadweight loss, a correction of this that led to improved socioeconomic efficiency should not be treated as a tax expenditure. It is thus crucial to find ways to determine whether a tax expenditure has these effects or not. It was noted that tax expenditures were likely to lead to improved socioeconomic efficiency if real incomes increased, if employment increased, if deadweight losses decreased or if external effects shifted. But even if the government admitted that it was desirable to make quantitative studies of such effects of tax expenditures, this would not always be practically possible because of the data required and the methodology needed. The government, however, concluded that it was often able to make a qualitative estimation of such effects, which it was noted was the preferred method (Government written communication 2009/10:195, 17).

One area where this type of optimal taxation approach has been applied is the taxation of closed corporations. The 1991 tax reform included rules aimed at preventing tax-minimizing shifting of income in order to negotiate the large differences in marginal tax rates on capital (30 percent) and labor income (51 percent) that was introduced with the dual income tax system. If taken to extreme lengths, all high wage earners would set up their own corporation to shift compensation for their labor supply to the corporate level. To prevent such income shifting, a system was implemented, whereby owner-managers in smaller businesses could split their income into two components - labor income and capital income (Alstadsæter and Jacob 2012, 31). The Swedish income-splitting system, the so-called '3:12 rules', that was introduced in 1991 applies to active owners in corporations where four or fewer owners control at least 50 percent of the shares. The 3:12 rules assert a return to equity in the corporations, creating a 'dividend allowance' (*gränsbelopp*). The dividend allowance is calculated in two parts: the wage-based dividend allowance depends on the total wage bill of the corporation, while the equity-based dividend allowance depends on the nominal equity of the corporation. Nominal equity consists of paid-in share capital and any unconditional shareholders' contribution (Alstadsæter and Jacob 2012, 32). From 2006, dividends within the active shareholder's dividend allowance (based on the ownership share) are taxed as dividends at a flat rate of 20 percent. Dividends in excess of the dividend allowance are taxed as labor income, where the marginal tax rate depends on the shareholder's total wage income from all sources (Government bill 2005/06:40; Alstadsæter and Jacob 2012, 32).

In this regard, it has been noted that the 2006 reform meant that the 3:12 rules were very generous for many owner-managers of smaller businesses. The dividend tax rate has been cut from 30 to 20 percent and the annual dividend allowance often exceeds nominal equity in a corporation (Alstadsæter and Jacob 2012, 35). Corporations are founded to enable owners to participate in and benefit from income shifting using the 3:12 rules. In 2006, about a third of all newly founded closely held corporations were holding corporations, shell corporations or low-turnover companies. High-income individuals in particular founded holding corporations or shell corporations after the reform (Alstadsæter and Jacob 2012, 41-43).

Since 2006, there has been a lot of criticism regarding the exploitation of the 3:12 rules by some groups and the legislation has also been subject to review since 2013 (Tjernberg 2013). Following this critical perspective, we will focus on how the center-right coalition (*Allians för Sverige*) which came into office in 2006 has framed the 3:12 rules. The coalition repeatedly increased the share of the dividend allowances, motivating it as a policy aimed at stimulating entrepreneurship and growth. The government wanted to improve the conditions for small businesses and make it more attractive for people to own businesses (Government bill 2006/07:1, 152). It should be noted here that, formally, the government regarded reduced dividend tax rate as a tax expenditure (Government written communication 2008/09:183, 20). However, it also motivated this deviation from uniformity by claiming that political objectives, such as more entrepreneurship, were a more important argument than preserving neutrality in the tax system (Government bill 2011/12:1, 430). While the government did not go so far as to declare that the reduced dividend tax rate for closed corporations was not a tax expenditure, it is an indication of a how a new type of tax design that refuted the foundations of the 1991 tax reform has been introduced in small installments.

9.4. Other tax policy changes after the 1991 tax reform

There are also other occasions in the making of Swedish tax policy after 1990 where tax principles have not been applied. The aftermath of a tax review by the so-called 'Commission on Tax Base Mobility' (*Skattebasutredningen*) that was convened in the period 2000-2002 is one example of this. This Commission was instructed by the government to examine how the tax system should be designed in order to raise sufficient tax revenues to continue to finance a well-functioning welfare society at current levels of ambition in a global context with increased tax mobility (SOU 2002:47, 5). At this point in time, it was obvious that the strategy was to adapt the Swedish tax system to the pressures from globalization through a tax reform, rather than a ‘race to the bottom’ (SOU 2002:47, 30). This was also the point of departure for the Social Democratic government as it instructed the so-called ‘Property Tax Commission’ (*Egendomsskatteutredningen*) to prepare proposals for reforms to the inheritance and gift tax, the wealth tax and real estate tax on the basis of the review from the Committee on Tax Base Mobility (Commission of Inquiry guideline 2002:87).

The inheritance and gift tax, the wealth tax and the real estate tax had not been included in the 1991 tax reform. Nevertheless, in its proposals to reform these taxes both the Commission on Tax Base Mobility and the Property Tax Commission strived to extend the principles of uniformity and horizontal equity to those taxes. The reports from the Property Tax Commission included a number of proposals concerning the valuation of assets which reflected the view that uniformity was still a tax principle which characterized a ‘good’ tax system (SOU 2002:47; SOU 2004:36; SOU 2004:66).

However, none of the key recommendations by the Commission on Tax Base Mobility or the Property Tax Commission were implemented. Apparently, there was no real political ambition or capacity among politicians to commit to a wider reform. Instead, the taxes examined were either repealed or adapted to fit into short-term political concerns which were passed by Parliament as part of the annual budget or as part of bills prepared by the Finance Ministry.

The inheritance and gift tax was abolished in 2005 by the Social Democratic government (Government bill 2004/05:25). The center-right coalition government which came into office in 2006 then repealed the wealth tax in 2007 (Government bill 2007/08:26). This government also abolished the tax on immovable property completely and replaced it with a low property tax payable to the local municipality from January 1, 2008. Sørensen has noted that the government abolished the previous design of the property tax, where it was in proportion to the assessed value of the property. Instead, the new property tax for villas was a fixed amount of 6,000 SEK per year, but with a cap equal to 0.75 percent of the assessed property value. For apartment buildings the new property tax amounted to 1,200 SEK per apartment, with a cap of 0.4 percent of the property value. For a majority of residential property owners, the reform meant that the tax is no longer related to the market value of the property and that the recurrent property tax is significantly lower than before. However, the government also raised the tax rate on realized capital gains on owner-occupied villas and apartments from 20 to 22 percent to compensate for part of the revenue loss resulting from the reform. Other rules were also changed. As a means to limit lock-in effects, taxpayers were previously allowed to defer all of their capital gains tax bill if they reinvested their gains in a new residential property. However, under the new rules the gain that may be deferred is capped at 1,6 million SEK. To limit the benefit from tax deferral, taxpayers are also obliged to include an imputed interest rate of 1.67 percent of the deferred capital gain in their annual taxable capital income (Sørensen 2010, 101-102; Government bill 2007/08:27).

Another tax policy decision where tax principles have had a limited impact is the introduction of the Swedish system of Earned Income Tax Credits (EITC) (*jobbskatteavdraget*). During its time in office (2006-2014), the center-right coalition cut personal income taxes through the introduction of EITC, which was combined with cutbacks in unemployment and health insurance benefits. The reform was to boost employment by providing marginal incentives for individuals to go from unemployment to, at least, part-time work (Government bill 2006/07:1, 136). However, it should be noted that the Swedish adaptation of the EITC differs from the EITC programs that exist in many other countries, for instance the US and the UK. In both of those countries the EITC targets only certain groups of taxpayers, such as low-income families, whereas in Sweden the EITC targets the whole working population (all wage-earners). Against this background, it has proved a very difficult task to evaluate the EITC (Edmark et al 2012). The fact that the Swedish EITC applies to the whole working population may lead to the conclusion that the EITC reform, at least in significant parts, was intentionally designed as a cut in personal income tax for high and middle earners who traditionally supported or would potentially support the center-right coalition. There are, nevertheless, many elements in the Swedish EITC policy which resemble the tax policy traditionally favored by the Swedish Conservative party.

10. The development of energy and environmental taxes after 1973

10.1. From the oil crisis to the 1991 tax reform: putting the issue into context

It is often rightly noted that Sweden was an early mover in recognizing global warming as a problem that necessitated political action. One example of this was the introduction of the carbon tax in early 1991, which can be seen as the starting point of an active climate policy. However, from a longer historical perspective it might also be noted that the transition to an internationally low carbon intensity had already taken place during the 1970s and 1980s. Swedish carbon dioxide (CO2) emissions were cut by approximately 40 percent between the early 1970s and the late 1980s, which should be compared with the five percent cut between 1990 and 2005. This means that the largest cuts in carbon dioxide emissions took place prior to the implementation of an active climate policy (Lindmark 2016).

It is crucial to frame this outcome within the Swedish strategy to reduce oil dependency after the sharp increases in oil prices that occurred in 1973 and 1979, respectively. From a comparative international perspective, it has been preliminarily estimated that the transformation pressure created by the Swedish state through measures such as taxes, research and development incentives and subsidies can explain roughly 15 percent of the total reduction of oil intensity during the period 1979-1991 (Lindmark 2016). During the period 1973-1990, there were a number of excise duties on energy taxes. Regarding fuels, these included petrol tax, a general energy tax as well as a special tax on oil products and coal. Electricity was also subject to a number of taxes, including the general energy tax which was levied on all electricity produced or distributed in Sweden, a tax on hydroelectricity production and a tax on nuclear power production (SOU 1989:83, 146-149 and 163-164).

The purpose of this energy taxation can only be understood from a multidimensional perspective. There is no doubt that energy taxation was related to addressing energy security, economic and environmental concerns (cf. Government bill 1989/90:50, 87). However, there were also much more complex links between the strategy to reduce oil dependency on the one hand and energy taxation on the other. Here, it might be argued that energy taxes already existed for fiscal reasons and that this purpose was simply extended to finance subsidies in order to reduce oil dependency. As tax revenues increased, these were partly used to build up of the so-called ‘oil fund’. As such, the energy tax became an instrument for ensuring a fast reduction in oil dependency by financing a subsidy program, administered by the oil fund (Lindmark 2016; Ds 1994:33, 19).

It could thus be argued that taxes played a minor role in affecting oil consumption in the aftermath of the OPEC I crisis in 1973 but also that the role of taxes during the 1980s was smaller than during the era of active climate policy from the 1990s. Rather, it was the overall transformation pressure that created a larger-than-expected response compared with other countries. In this regard, the state, business and enterprise, as well as consumers, made reasonably well-informed investment and consumption decisions, based on world market prices and their respective utility function (Lindmark 2016). One example of this is the new energy technology developed within the pulp and paper industry in close collaboration with the state (Bergqvist and Söderholm 2014). If the total replacement of oil in the pulp and paper industry is seen as new technology, it explains around 13 percent of the reduced oil consumption between 1973 and 1990 (Lindmark, Bergqvist and Andersson 2011; Lindmark 2016).

10.2. The 1991 tax reform and beyond

The 1991 tax reform introduced a number of changes within energy taxation. The energy sector, with the exception of aviation fuel, became subject to 25 percent VAT. In addition, the petrol tax was increased from SEK 2.58 to SEK 2.92 (Government bill 1989/90:50). The 1991 tax reform also gave energy taxation a more pronounced environmental profile as a CO2 tax of SEK 0.25 per kilo emission was levied on all fossil fuels under the General Energy Tax Act from 1991. The CO2 tax was designed as an excise duty. At the same time, the General Energy Tax was reduced by 50 percent in order to limit tax increases that would cause difficulties for many industries and households (Government bill 1990/91:111; Lag (1990:582) om koldioxidskatt [Law on Carbon Dioxide Tax (1990:582]; Färe et al 2017, 2-3).

Another environmental tax introduced with the 1991 tax reform was that on sulfur. This tax was set to SEK 30 per kilo emission of sulfur dioxide from coal and peat, and to SEK 27 per cubic meter for each tenth of a percent by mass of sulfur content in oil (Färe et al 2017, 2). As with the CO2 tax, the introduction of the sulfur dioxide tax was part of a long-term political strategy to prevent acidification which meant that it reinforced the significant drop in emissions that had started in the 1970s (Brännlund 2009, 197-98; Government bill 1990/91:111).

As for the intentions behind these changes, it might be argued that the government sent a dual message in the two different government bills which announced these changes. On the one hand, energy taxes such as excise duties were viewed as fiscal taxes and a new tax base that could replace the revenue that had been lost through cuts in income and capital income taxation in other parts of the 1991 tax reform (Government bill 1989/90:50). On the other hand, the CO2 tax was framed as a non-fiscal environmental tax which was introduced in reaction to the new political awareness of global warming as an environmental problem (Government bill 1989/90:111). This reflects the fact that excise duties often have a double function. They are generally motivated by the fact that the consumption of particular goods and services generates externalities in situations when consumption has negative spillovers affecting people´s welfare. This is often used as an argument for environmental taxes. However, excise duties frequently exist in order to produce additional tax revenue (Olsson 2001, 18).

The environmental tax system has continued to evolve since the beginning of the 1990s. In 1992, a fiscally neutral charge on nitrogen oxide emissions from large energy-producing combustion plants was introduced. The fee was set to SEK 40 per kilo of emission and was increased to SEK 50 in 2008. In 1993, an energy tax reform that led to substantial increases in energy and CO2 tax rates was introduced. However, the manufacturing industry was exempted from paying energy tax and needed to pay only 25 percent of the statutory CO2 tax rate. This exception was allowed in order to protect the global competitiveness of the Swedish energy-intensive industries. Consequently, the tax increases mainly affected households. However, in 1997, the industrial CO2 tax was increased to 50 percent of the statutory CO2 tax rate. The statutory tax rate was thereafter increased, stepwise, from SEK 0.37 in 2000 to SEK 1.08 in 2004, with further increases to SEK 1.05 in 2009 and to SEK 1.12 in 2015. For those industries included in the EU Emissions Trading System, which came into force in 2005, the CO2 tax was gradually phased out from 2008 until it was completely removed at the end of 2010. The exemption from energy tax for the manufacturing industry was removed in 2004, in connection with an energy tax being levied on electricity used in production. The tax rate was set to SEK 0.005 per kWh, which corresponded to the minimum requirement according to the EU Energy Tax Directive (Färe et al. 2017, 2-3).

Another notable feature in the tax system is a number of tax shifts between individual labor income tax (which have been reduced) and energy and environmental taxes (which have been increased) (SOU 1997:11; Government bill 2000/01:1). One important factor behind this policy choice is that Sweden was governed by successive Social Democratic minority governments which relied on parliamentary support from the Green Party during the period 1998-2006. As the Green Party championed the idea of such tax shifts, they were able to persuade the Social Democrats to accept such revenue changes in the annual national budget, as part of a larger compromise.

The design of environmental and energy taxation in Sweden has also been influenced by developments in several policy areas, which have both national and international dimensions. In this regard, national environmental and energy policies as they have been adapted to international agreements, such as the United Nations Framework on Climate Change, the Kyoto Protocol and the Paris Agreement, have functioned as important guidelines for environmental and energy tax changes (Government bill 2001/02:55; Government bill 2008/09:162; SOU 2016:47).

11. Current fiscal policy and its challenges

In June 2016, a parliamentary study commission on the future direction of public finance agreed on a reform of the budgetary framework initially adopted in the latter part of the 1990s. The first major element of this reform, which will be implemented in 2019, is that the surplus target for general government net lending will be reduced to 0.33 percent instead of 1 percent on average over a business cycle. This shift is motivated by the fact that the public debt has decreased since the last surplus target was decided, combined with a recognition of the changing demographic profile with an ageing population. The second major element is the introduction of an anchor for the public debt level. According to the new rules, the general gross government debt, according to the definition in the Maastricht criteria, must not exceed 35 percent of GDP. If the general gross government debt diverges from the anchor by more than 5 percent, the government in office must report to parliament the reasons behind the divergence and what it intends to do to correct the situation. From this it follows that Sweden intends to stay well within the margins of the Maastricht criteria, especially as the new surplus target is expected to continually reduce the general gross government debt in order to meet the agreed target (SOU 2016:67).

In a comment to this agreement, former finance minister Kjell Olof Feldt, together with Lars Anell and Michael Sohlman, has noted that it is probably impossible for any political party that wants to undertake major social reforms or expand the welfare state to finance this through borrowing in the credit market. Instead, any realistic plans for reform must be accompanied by an increase in revenue through raised taxes (Anell, Feldt and Sohlman 2016). Here, they reveal a growing realization among observers of the welfare state and the public sector about the structural effects of the tax policy over recent decades. The tax-to-GDP ratio has dropped from 50,4 percent in 1990 to 43,3 percent in 2015 (Statistics Sweden, Tax Ratio 1980-2015, percentage of GDP). This faces politicians with an uncomfortable dilemma. They could raise taxes and ensure that taxpayers comply with such measures, which might prove unpopular with the voters, or they must admit that they have little more to offer than upholding a continued, static trajectory and hope that it is not disturbed by economic crises or other exogenous shocks.

12. Conclusions

In this paper, we have demonstrated the normativity of principles in establishing coherence in the modern Swedish tax system, but also the pragmatic use of principles. The ability-to-pay principle was used as policy objective as well as a legal principle for the introduction of the modern income tax. It was particularly important for defining the income concept and the tax subject. The progressive income tax was also legitimated on the basis on the ability-to-pay principle, serving as the foundation for the income tax reform in 1947. Together with the efficiency principle, as it was introduced in the 1938 tax reform, it was guiding for how the post-war tax system was constructed. In 1971, a new reform confirmed the ability-to-pay principle as a guideline for the tax system, however given a somewhat new interpretation. In contrast to the introduction of the 1928 income tax Act and the 1952 tax reform, the principle was now used to legitimate individual taxation instead of joint taxation of spouses. The reform also combined the ability-to-pay principle with a strong emphasis on social justice based on several, interrelated perspectives. This was manifested in the introduction of individual taxation to promote gender equality. The 1971 reform also stressed the importance of the social policy principle as it promoted the economic and social status of low-income groups.

While some elements in the 1971 tax reform were adjusted during ‘the wonderful night’ in 1981, it was mainly still in place until the 1991 tax reform. The 1991 tax reform transformed the tax system that had been in place and had evolved since 1902 with the introduction of dual income tax. The overall political ambitions for the tax system also shifted to promote a much wider perspective regarding growth, savings and investment than in the previous system where vertical equity and redistribution had been the most important considerations. After the tax reform in 1991, there was no longer any significant difference between the taxing of working capital within industry and other sources of capital. As the dual income tax model implies that capital income tax must be uniform, the 1991 tax reform was based on tax principles such as horizontal equity and neutrality.

There is no doubt that the 1991 tax reform was well designed and built on careful, principled considerations. However, it was also implemented when the economic crisis in the first part of the 1990s meant that many of its preconditions were radically transformed. The financial crisis in the public sector meant that the arrangements which were introduced as guarantees for a continued vertical equity had to be renegotiated. Several tax expenditures which have shifted originally uniform rates within VAT and company taxation have also been introduced. In such circumstances, changes have been made to promote short-term goals within economic policy. However, despite them being introduced under the explicit circumstance that they represent necessary exceptions from the principles of uniformity and neutrality, such changes appear to have become permanent. Furthermore, the sheer number of tax expenditures indicates that the system has gradually, but steadily, departed from the tax principles introduced in the 1991 tax reform.

We have also noted that the Commission on Tax Base Mobility, the Commission on Unified VAT and the Property Tax Commission, all from the around 2005, represent the last notable major political effort to advance the tax system introduced after the 1991 tax reform. In this respect, it might be argued that tax policy since then has been exposed to a phenomenon which may be called 'detaxation'. Structural such detaxation refers to systemic removal or reduction in broad-based income, consumption and wealth taxes that are justified by diffuse and non-specific policy goals, such as enhancing growth or stimulating economic activity (Lahey 2008; Lahey 2011). Through this process, the principle-based governance that has traditionally characterized Swedish tax policy appears to have weakened further as politicians have reduced or abolished taxes without any apparent consideration to the long-term stability of the tax system.

12.1. Implications for policy change and further research

The results in this study suggest that there is potential for further integration within Swedish tax policy of areas such as income distribution, social inclusion and gender equality, which the EU has identified as central in its sustainability strategy (European Commission 2016a). Given that the EU would take the initiative to harmonize the sustainability policies of its Member States, what then would be the implications in relation to Swedish tax policy? In this regard, it must be noted that the Swedish tax system is characterized by a policy paradox where acceptance of international tax competition co-exists side by side with a determined defense of national tax sovereignty. In this, Sweden follows a pattern identified by Diane M. Ring. According to Ring, sovereignty maintains a prominent place in the tax policy discussion even when nations decide whether to tackle some of the more challenging problems of international tax. In this respect, assertions of tax sovereignty reflect more the conception of the sovereign state. As the concept of sovereignty has been transformed to mean a state that is responsible for its people, the question of a state´s legitimacy requires this duty to be satisfied. This means that protection of the revenue source (taxes) and, correspondingly, the state´s taxing power become crucial parts of a state´s duty to its people (Ring 2008).

From this it follows that any tax harmonization attempt by the EU, related to sustainability, needs to have a democratic anchorage which convinces the citizens that it coincides with the national interest as manifested in sovereign tax policy. If such an attempt is not successful, Sweden is likely to argue that that it wants to preserve the tax base for the universal welfare state as a means of preserving its national tax sovereignty (cf. Ring 2008, 210-11).

13. References

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14. Project information

FairTax is a cross-disciplinary four year H2020 EU project aiming to produce recommendations on how fair and sustainable taxation and social policy reforms can increase the economic stability of EU member states, promoting economic equality and security, enhancing coordination and harmonisation of tax, social inclusion, environmental, legitimacy, and compliance measures, support deepening of the European Monetary Union, and expanding the EU's own resource revenue bases. Under the coordination of Umeå University (Sweden), comparative and international policy fiscal experts from eleven universities in six EU countries and three non-EU countries (Brazil, Canada and Norway) contribute to FairTax research.

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