

# SWEDISH TAX REFORMS 1971–77 —WHY SO MANY?

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abridged but somewhat condensed form: among other things, the original paper contains a  
rather exhaustive statistical documentation.

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## INTRODUCTION

If a tax system is to fulfil its function adequately it must continually be adjusted in order to keep it in line with the economic changes in the community. During the post-war period Swedes have learnt to accept the idea that major adjustments in the tax system are needed at intervals of about 4–5 years. Considerable changes in income taxation were made in 1947, 1952, 1957, 1962, 1966 and 1971.<sup>1</sup> All of the changes made after 1947 involved a reduction—at any rate temporarily—of national income tax, often in exchange for other forms of tax. The reform of 1971 involved a particularly drastic reduction, national income tax having then been cut by 3 600 million kronor,<sup>2</sup> close on 20 % of the total national income tax.

Nevertheless, already in the following year it was considered necessary to make a further reduction of 2 400 million kronor as from 1973.<sup>3</sup> This reduction, too, was several times greater than the earlier ones. In 1974 came the next reform, the abolition of the old-age pension contribution; this meant that the tax burden of individuals was reduced by a further 3 800 million kronor.<sup>4</sup> The next adjustment was made in 1975 at a cost of 4 700 million kronor;<sup>5</sup> and already in the spring of 1975 the Riksdag decided upon a reform for 1976 involving a reduction of national income tax by about 5 000 million kronor.<sup>6</sup> For the year 1977, too, tax cuts of 6 500 million kronor have been decided by the Riksdag.<sup>7</sup>

These considerable reductions, amounting together to more than 25 000 million kronor, have not, however, meant that the amount levied in national income tax, including old-age pension and health insurance contributions, has fallen in nominal terms during the period. In the fiscal year 1970/71, income tax yielded about 18 000 million kronor<sup>8</sup> and may be

<sup>1</sup> For an analysis of the development and effects of income taxation during the period 1952–71, see Jakobsson–Normann, 1974. These authors present a simulation model for personal income taxation in Sweden and with the aid of this model they analyse the effects of this taxation in different respects.

Full titles of works referred to in this article are given above under the heading References.

<sup>2</sup> *Prop.* 1970: 70, p. 78.

<sup>3</sup> *Prop.* 1972: 95, p. 1.

<sup>4</sup> *Prop.* 1973: 144, p. 27.

<sup>5</sup> *Prop.* 1974: 132, p. 75.

<sup>6</sup> *Prop.* 1975: 92, pp. 85 f.

<sup>7</sup> *Prop.* 1976/77: 42.

<sup>8</sup> This and following data concerning the size of the taxes and of the national economy in general have been taken from the Budget and Finance Bill for the years in question.

estimated to yield about 30 000 million kronor in the budget year 1977/78. In real terms, however, this means approximately unchanged state revenue. However, the relative importance of national income tax has been considerably reduced during the period. In the budget year 1970/71 national income tax amounted to more than 40 % of the income on the operating budget. For 1977/78 the share is only about 30 %.

This situation prompts a number of questions.

What happened in connection with the 1971 reform to break the earlier pattern of major tax changes once every four years or thereabouts? Why did it become necessary to have reforms every year or almost every year? How is it that changes, which over a seven-year period meant income tax reductions of more than 25 000 million kronor for households and which reduced the relative importance of national income tax, have had the effect that income tax has become increasingly unpopular, while at the same time the demands for a reform of income tax are becoming ever more insistent?

That part of the answer to these questions is to be found in the development of inflation is pretty generally acknowledged. On the other hand, inflation cannot provide the whole answer, as it was not until the autumn of 1973 that a really high rate of inflation set in. The change in the structure of the tax scale which occurred in connection with the reform of 1971 would seem to have been a strong contributory factor. Here I propose to discuss, against the background of the distribution of income among the taxpayers, the effects which may have been produced by the structure of the tax rate and by changes in this structure made during the period.

### *Distribution of the tax burden*

The gross national product of Sweden amounted in 1976 to more than 250 000 million kronor. Of this about 125 000 million kronor was paid in taxes and social insurance contributions. It is true that a large proportion went back to the taxpayers (including nearly 50 000 million kronor in transfers to households), but such sums, too, have to be paid in to the public sector before they can be redistributed.

According to the income tax assessment statistics, the total income of all Swedish households amounted in 1971 to 116 000 million kronor and in 1973 to about 134 000 million kronor. In 1973 48 000 million kronor, or 37 % of the total income of households, was paid to the revenue authorities in direct taxes. To this must be added other taxes—especially value-added tax—which are intended to take a further 20 000 million kronor from

household incomes by means of indirect taxation. Thus, together, direct and indirect taxes take more than 50 % of total household income.

The nature of the distribution of income among households is of decisive importance for the way in which this tax burden can be distributed among them.

The income tax assessment statistics for the years 1971 and 1973 show a number of interesting features in the distribution of incomes. The disparity in average and median income as between married men and other income-receivers is very evident. Although married men do not constitute more than one third of all income-receivers, they account for more than half of the total figure for incomes. Of greater importance in the present context, however, is the income distribution among income-receivers taken as a whole.

A striking feature is the large proportion of people with low incomes. Thus in 1971 63 % of those income-receivers whose income was recorded had an income of less than 25 000 kronor, 81 % had less than 30 000 kronor and 96 % had less than 40 000 kronor. The median income was only 19 200 kronor. The corresponding percentages for 1973 were 54, 64 and 84, while the median income was 23 200 kronor. In the general debate during recent years much has been said about the so-called intermediate rate groups with incomes of 30–50 000 kronor. As will be seen, the median income is far below that level. There are several explanations for this difference between the actual median income and the sort of figure generally regarded as normal earnings. The number of income-receivers in 1973 was 5 436 083, while the number of persons employed was only 3 879 000. The large group of non-employed income-receivers consists largely of people with low incomes, such as pensioners, and children with incomes from capital, etc. Furthermore, there are many employed persons who do not work full time or do not work all the year round, and this, too, brings down the median income.

In distributing a tax burden which amounts to about 50 % of the combined incomes of households, it is not only the distribution-policy objective that has to be borne in mind. Which income brackets<sup>9</sup> contain incomes of significant volume from the fiscal point of view is a further consideration of decisive importance. An income-distribution curve showing how large a

<sup>9</sup> By income bracket is meant an interval between two selected income limits, e.g. 15 000 and 20 000 kronor. By income-receiver in a certain income bracket or a certain income level is meant an income-receiver whose total income reaches a certain income bracket. An income-receiver who has an income of, e.g., 32 000 kronor and who is thus an income-receiver in the 30–35 000 kronor bracketed also has, of course, income in all brackets below that. By total income in a certain income bracket is meant the combined incomes in this bracket of all those income-receivers who have incomes within the bracket, irrespective of what is the highest bracket attained by their own total income.

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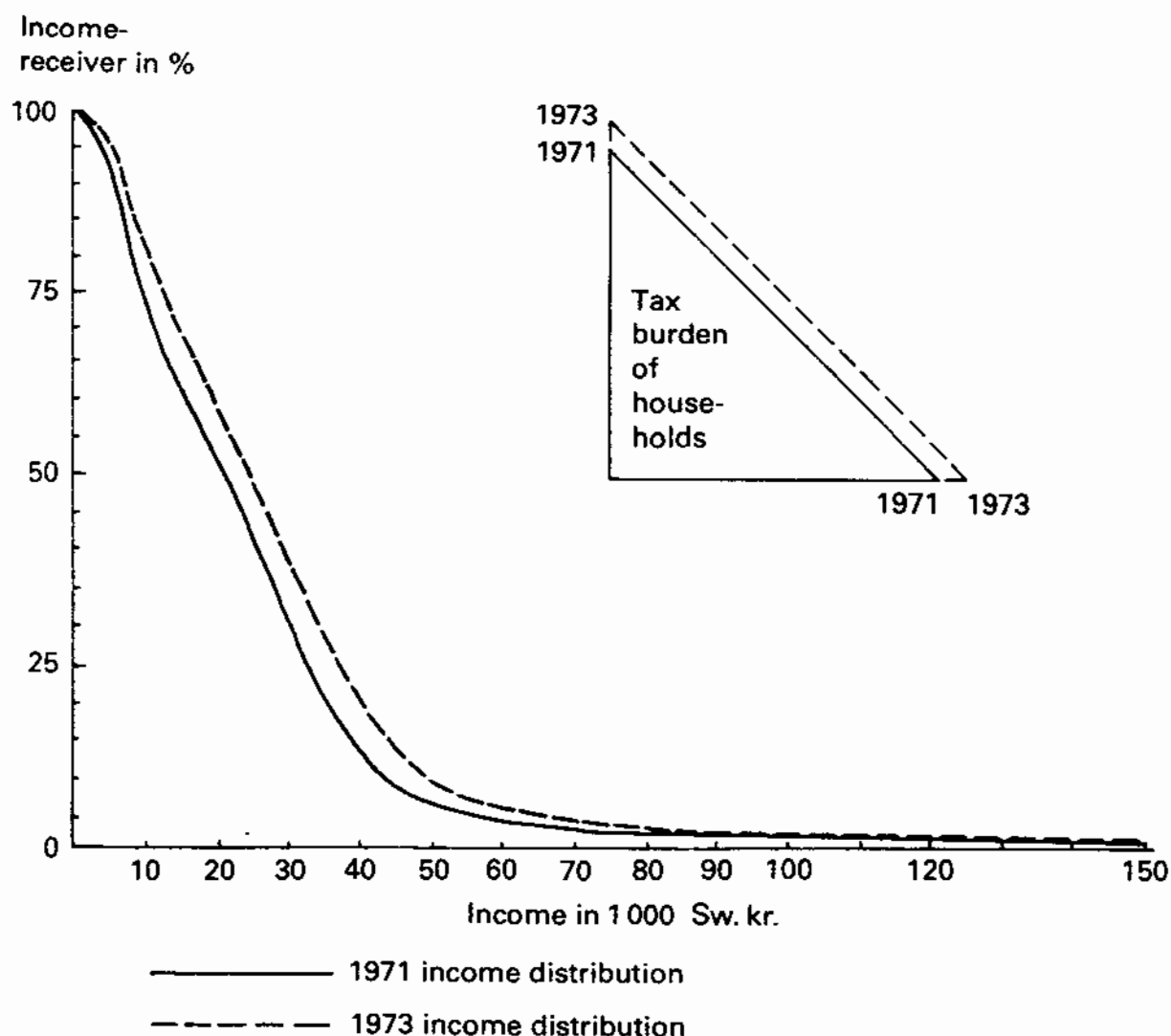


Fig. 1. Income distribution 1971 and 1973: married persons (sole earners in family). (The curve shows the proportion of income-receivers who received at least the income given on the horizontal axis.)

proportion of the whole body of income-receivers have at least a certain income will serve to illustrate this point.

The income-distribution curves in *Fig. 1* show, first, how rapidly the number of income-receivers declines with rising income and, secondly, how the general income level has risen between 1971 and 1973. One notices how small is the group of income-receivers generally regarded as enjoying high incomes. A more important feature, however, is that the curves and the area which is delimited by the curve and the X and Y axes show the size of the combined incomes and thus the tax basis in different income brackets. This reveals the dominating impact of the tax basis constituted by the income brackets below 40 000 kronor and how limited by contrast is the importance as a tax source of the higher income brackets. Of the combined incomes in 1971 and 1973, 93 and 90 % respectively are to be found in income brackets below 40 000 kronor. The area representing the combined incomes of households can be compared with the area of

the triangle inset above the diagram, which corresponds to the amount of tax obtained,<sup>1</sup> in 1971 and 1973 50 % of the combined incomes of households—directly and indirectly. Thus the area of the tax triangle is precisely half of the area in the income-distribution diagram representing the combined incomes. The comparison reveals how limited is the scope for variations in the distribution of taxes at a 50 % extraction rate.

The following compelling, and perhaps depressing, conclusions are among those that can be drawn from the diagram:

(1) Since the tax basis is mainly to be found in the lower income brackets, it is necessary to devise the taxation in such a way that it has an effective impact on these layers as well as others, if the taxation of households is to continue to be an important source of income for the public sector. If there should be a need to raise the amount of tax taken from households, it is essential to devise the tax increase in such a way that it hits the lower income brackets as well as the higher ones.

(2) Under these circumstances the forms of the taxes imposed will be of no significance as far as the tax pressure on the medium-income-receiver is concerned, since the tax must always be levied in such a way that it hits him. To put the matter bluntly, the situation of low- and medium-income-receivers as a group is that other taxes, e.g. the value-added tax, which he cannot avoid, will have to be raised if people stop drinking or smoking in order to escape the high extra taxation on alcohol or tobacco.

(3) With a progressive taxation of income, it is not possible to any significant extent to transfer the tax burden from the lower income brackets. But even if an extra taxation of high-income-receivers is of very marginal significance from the point of view of the public finances, this does not mean that there is no argument for progressive taxation. Apart from the distribution-policy objective, there is the consideration that the heavy taxation of the lower-income-receivers would probably not have been psychologically possible if the taxation of the higher incomes had not been made even more severe. For the purposes of our further discussion, however, it is important to establish that the steeply progressive income taxation mainly has distribution-policy effects but very limited revenue effects owing to the limited tax basis in the higher income brackets. The progressivity can therefore chiefly be discussed from a distribution-policy angle.

#### *Marginal tax and average tax*

Before going on to discuss the income changes of the 1970s, it will be advisable to make clear how a progressive scale of taxes is constructed.

<sup>1</sup> The triangular form of the area representing the tax pressure has been chosen with the appearance of the income-distribution curve in view, in order to facilitate comparison.

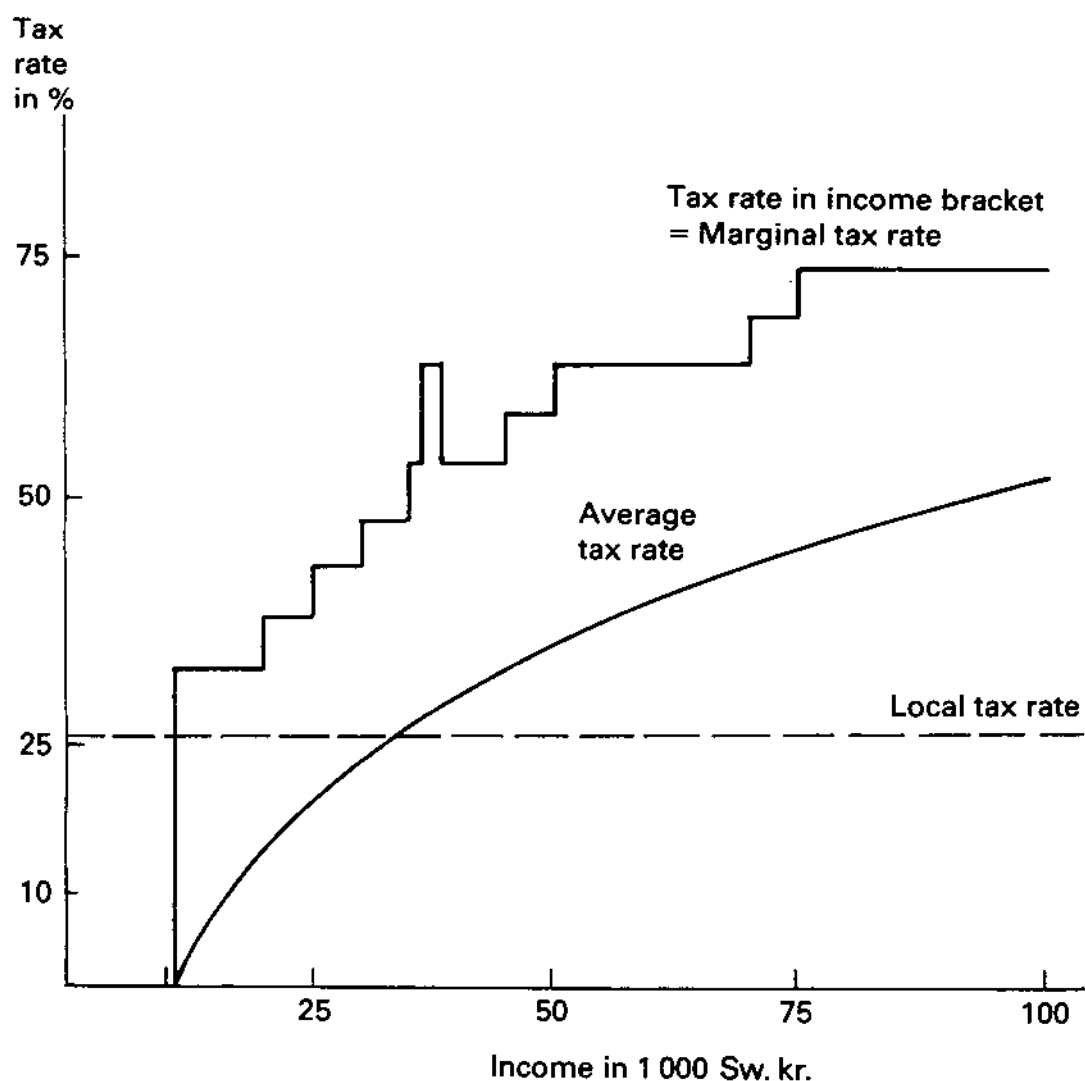


Fig. 2. Marginal tax rate and average tax rate on 1975 incomes for taxpayers with "tax reduction".

In the debate on taxation it has often been maintained that marginal tax rates are only of peripheral interest and are mainly a problem concerning high-income-receivers. According to this view it is only worth while discussing a person's average tax or total tax. This approach, however, seems to be based on a wrong conception, inasmuch as the tax scales can be said to be built up of a series of marginal tax rates, namely the tax rates in the different income brackets. The sum of the tax which is obtained in the different income brackets in which an income-receiver has income constitutes his total tax. The average tax is a result of the tax rates in the different income brackets. The difference and the relationship between marginal and average tax are shown in *Fig. 2*, from which it is evident that the construction of the progressive tax scale determines how the average tax can be varied for different groups of income-receivers.

There is, however, a further connection between marginal and average tax rates which has to be considered. The percentage increase in income



after tax resulting from a given wage increase—i.e. the size of the increase of disposable income and thus of the improvement in the standard of living—is determined by the relation between average tax and marginal tax. Marginal tax expressed in absolute terms tells us very little about the possibilities of an improvement in the standards. This can be illustrated by the following example. Two persons, A and B, earn 100 000 kronor and 10 000 kronor respectively. A pays 90 % of his income in tax, i.e. 90 000 kronor, and thus has an income after tax of 10 000 kronor. B has to pay 10 % or 1 000 kronor in tax on his income and so has a retained income after tax of 9 000 kronor. Both get a wage increase of 10 %, on which A has to pay 90 % or 9 000 kronor in tax and keeps 1 000 kronor, while B continues to have to pay 10 % or 100 kronor in tax and can keep 900 kronor. Although the tax pressure for A is considerably higher, both persons get an equally large percentage increase of their disposable income after tax. Thus it can by no means be taken for granted that the person who has the highest marginal tax will derive the least relative net wage increase from a wage rise of a given percentage. Instead, what happens is determined by the relation between the income increase minus marginal tax and the total income minus average tax. This relation is usually called elasticity of income after tax.<sup>2</sup> In a proportional tax system the elasticity is equal to one. The elasticity is reduced when the marginal tax rate is raised and it is increased when the average tax rate is raised, and vice versa. This tax parameter is extremely useful when it is a matter of describing the effects of the income tax reforms of the 1970s.

The reason for this is that the elasticity of income after tax forms what is probably the best measure of the levelling or distributional effect and can also be used for measuring the progressivity of the system. The level of the absolute marginal tax, on the other hand, provides no measure either of the progressivity or of the distributional effect of the taxation.

In the discussion of the contents and the effects of the tax changes of the 1970s we shall use as an example the tax development for the category constituted by married couples where only one of the spouses has income. Although this is not the largest group of income-receivers, it is perhaps the one which is most important from the economic point of view. In calculating the tax burden we have taken into account both national and local income tax as well as the old-age pension contribution and the health insurance contribution (so long as these contributions were payable). The discussion will be concentrated round the question how the elasticity of income after tax, i.e. the relation between average tax and marginal tax

<sup>2</sup> Jakobsson–Normann, 1974a.

and thereby the distributional effects of the tax system, has been affected in different income brackets as a result of the different tax changes. In order to make the presentation more concrete, the income elasticity has been expressed as the percentage net wage increase after tax obtained by an income-receiver from a gross wage increase of 10 %.

The correctness of the choice of gross wage-increase percentage is a matter which can, of course, be discussed. Usually marginal tax and income elasticity are expressed on the basis of a rise in income from one marginal tax bracket to another or on the basis of an income increase of 100 or 1 000 kronor. This procedure, however, does not always give a fair picture of the effects of the system. Here it is probably more appropriate to link the calculations to the actual income development. During the period 1970–76 the development of earnings for a large body of wage-earners has involved annual wage increases of around 10 %—rather less than this during the first part of the period and rather more during the later part—while at the same time the development has been more favourable for the lower-income-receivers than for the higher.<sup>3</sup> For this reason it has seemed desirable to base the further discussion on a 10 % annual gross wage increase.

## THE DEVELOPMENT OF INCOME TAX 1970–74

### *Taxation before the 1971 reform*

At the beginning of the 1970s, when joint taxation of incomes of married couples was still the basic principle, the prevailing situation was as shown in *Table 1*.<sup>4</sup>

It will be seen from that table that both marginal tax and average tax were relatively high even for low incomes. For lower-income-receivers the old-age pension and health insurance contributions constituted a considerable part of the tax burden. In the main, marginal tax rose steadily with rising income, without sudden leaps.<sup>5</sup> This construction of the tax rates is reflected in the fact that the net income increase, i.e. the income elasticity,

<sup>3</sup> *Utredningsmeddelande*, SACO, E: 5 1975-02-03, appendix 1. The 1972 tax commission also makes use of a 10 % increase in gross income in order to illustrate the effects of an income increase in its report concerning the tax changes of 1975. *SOU* 1974: 20, p. 86.

<sup>4</sup> Tables 1–7 are based on basic material derived through the simulation model of Jakobsson and Normann for income taxation. I take this opportunity of expressing my gratitude for having been given access to this material.

<sup>5</sup> We here disregard the effects which arose owing to the construction of the health insurance contribution, which involved very powerful effects precisely at the transitions between income brackets. These effects, however, do not appear when marginal tax is calculated on an income increase as large as 10 %.

Table 1. *Income tax payable by married persons (sole earners in family) in 1970 (local income tax 21.00 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	23 %	11 600	36 %	8.3 %
20 000	26 %	14 800	37 %	8.5 %
25 000	29 %	17 850	45 %	7.8 %
30 000	31 %	20 550	46 %	7.8 %
35 000	34 %	23 250	52 %	7.3 %
50 000	40 %	30 200	55 %	7.5 %
75 000	46 %	40 450	62 %	7.0 %
100 000	51 %	49 500	65 %	6.9 %

was high at all income levels but declined with rising income. The distributional effect of the system was not particularly strong compared with the present situation but was increased throughout the tax scale, with rising income. The distributional effect, however, was noticeably stronger than it had been in, e.g., the tax scales of 1960.<sup>6</sup> The elasticity figures also show that the tax-rate structure was relatively insensitive to inflation. The structure was such that gross wage increases with strong inflationary elements could also result in considerable increases in disposable income.

### *The 1971 reform*

The extensive reform of the tax system which was carried out as from 1971, and which has been called the tax package of 1970, had as its main feature the introduction of individual taxation of the earned income of spouses and a more marked levelling of incomes (*Prop.* 1970: 70).

At the outset, the 1971 reform was planned to involve only a change-over to individual taxation of spouses. The report of the Royal Commission on family taxation showed that such a reform was very difficult to carry out without an overall reduction of tax rates (*Stencil Fi* 1969; 4-5). One of the reasons for this was that the taxes from those single persons who had to pay the high "bachelor tax" formed so big an item from the revenue point of view that compromises between the tax rates for married couples and those for single persons would involve unrealistically high taxes for married couples unless the total amount of income tax levied was reduced. The introduction of individual taxation made necessary the in-

<sup>6</sup> Jakobsson-Normann, 1974.

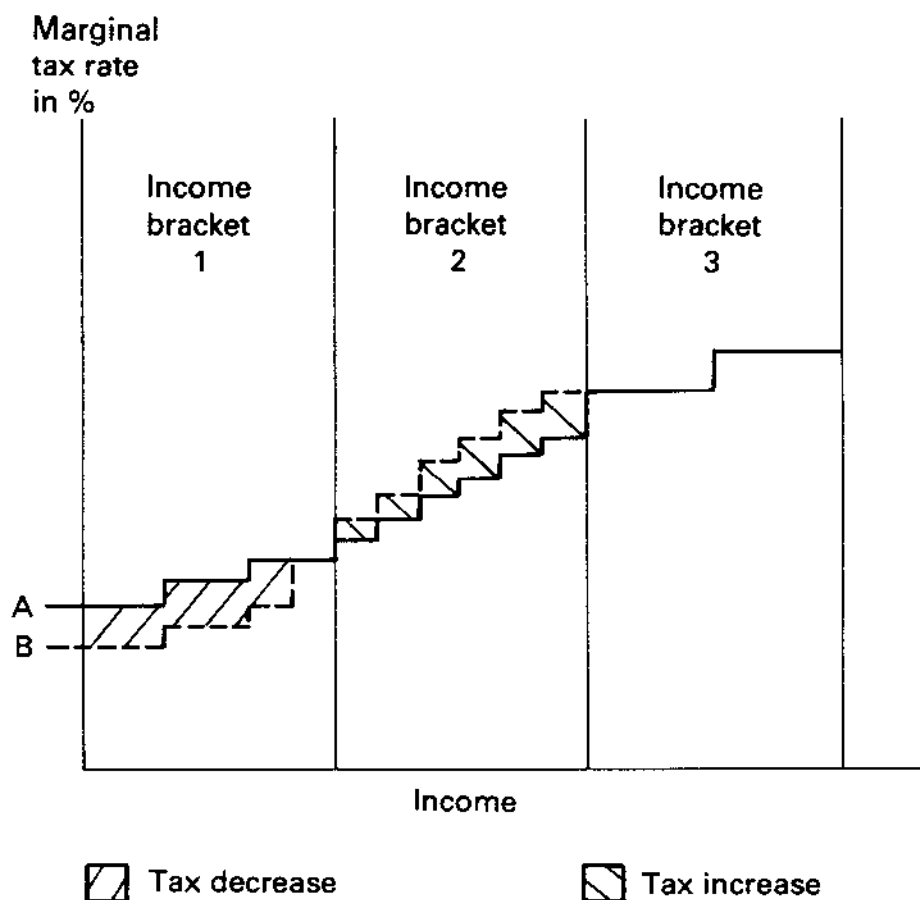


Fig. 3

tensification of the change-over to value-added tax which also formed part of the 1970 tax package.

The distribution-policy element in the reform which came to dominate the picture was introduced at a later stage. Income tax was reduced for all those whose income was lower than about 35 000 kronor and was raised for the majority of those receiving bigger incomes. Such a reform can only be brought about by reducing marginal taxes in the very lowest brackets and raising them in the higher brackets. Tax-scale changes of this type are not unusual; and in fact they have been used in every major tax change since 1952. In general, the reductions in national income tax which were undertaken up to the time of the 1970 tax package were made with the dual purpose of compensating for rises in local income tax and obviating excessively high marginal taxes for the larger groups of income-receivers.

The technique for a tax reform which aims at reducing tax for low income-receivers but not for high income-receivers can be illustrated graphically as shown in *Fig. 3*.<sup>7</sup>

In *Fig. 3* the continuous line A represents the marginal tax rate in the initial situation. A reform aiming at a reduction of tax for income-receivers

<sup>7</sup> For a different technique of presenting the problem, see Jakobsson-Normann (1974b).

in income brackets 1 and 2 and unchanged tax for income-receivers in income bracket 3 and above must take place according to the model which is indicated by the broken line B. The majority of the income-receivers in bracket 1 get a reduction both in average and in marginal tax. The size of the reduction of average tax at a certain income within a bracket corresponds to the area between the two tax curves from the lower limit of the bracket up to the selected income level. The income-receivers in bracket 2 get a reduced average tax but an increased marginal tax. The reason for the latter is that the tax reduction for the incomes in bracket 1 has to be compensated for by an equally large tax increase for the incomes in bracket 2—the increase must therefore be of such a size that the area between the tax rates in bracket 2 will be as large as the area between these rates in bracket 1—in order that the income-receivers in bracket 3 and above shall not get any reduction in average tax. The increased marginal tax and the intensification of progression which hit the income-receivers in bracket 2 are thus a function of the distribution-policy objective concerning the higher-income-receivers in bracket 3, whose situation is not affected by these changes in the tax rates in lower income brackets. For the income-receivers in bracket 2, on the other hand, the reduction in average tax and the increase in marginal tax mean a reduction of income elasticity and thus a deterioration of the possibilities for an increase of net income. This constitutes a complicating element in the process of carrying out tax reforms aimed at levelling incomes.

The changes undertaken in the tax scale up to 1970 were in general of so cautious a nature that they did not produce any very dramatic effects in this respect, as is apparent from the income elasticity figures in the tax rates which were applied up to the end of 1970.

The tax package of 1970 featured a bigger tax reduction than had been undertaken earlier, while at the same time imposing heavier taxes on those receiving incomes of more than 35 000 kronor. In order to achieve this, it was necessary to introduce a rise in marginal tax which was bigger than had been the case in earlier reforms and which also affected lower income brackets than had been involved in earlier changes. This meant a total change in the structure of the tax rates, a change which, remarkably enough, the Government deliberately abstained from presenting in the Bill. The contents of the reform are shown in *Table 2*.

The table shows that the marginal tax had to be raised already at the level of 20 000 kronor in order to enable the reform to be carried out. The increase at incomes of 30–35 000 kronor is particularly noticeable. Even at that level the marginal tax has reached such a height that the difference between it and the rate payable in higher income brackets is relatively

Table 2. *Income tax payable by married persons (sole earners in family) in 1971 (local income tax 22.54 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	15 %	12 850	37 %	7.4 %
20 000	20 %	16 000	42 %	7.3 %
25 000	25 %	18 850	48 %	6.9 %
30 000	29 %	21 400	56 %	6.2 %
35 000	33 %	23 550	61 %	5.8 %
50 000	41 %	29 450	61 %	6.6 %
75 000	48 %	39 100	67 %	6.4 %
100 000	53 %	47 500	71 %	6.2 %

small. The tax rates give a very marked levelling effect between incomes below 35 000 kronor and incomes above that figure but only a small levelling between the various income brackets above 35 000 kronor. The most interesting effect of the tax reform concerns the change in the income elasticity figures. Compared with the situation in 1970 (cf. *Table 1*) all income groups have suffered a deterioration of their possibilities of enjoying an increase in living standards. At the same time as the lower income elasticity increases the levelling effect in the lower part of the system, we find that the continued levelling effect is not equally strong. The progression effect is now strongest not in the highest income levels but at 35 000 kronor, where retention of a given percentage wage increase is least—i.e. a person receiving an income of this amount has to have a bigger percentage wage increase than other groups in order to obtain the same relative rise in his standard of living. The reduced elasticity figures also imply a greater sensitivity to inflation in the tax system.

The 1970 tax package also contained another feature, a reduction of the personal allowance, which accentuated these effects still further. The new personal allowance of 4 500 kronor was reduced by 20 % of the amount by which the individual's assessed income exceeded 30 000 kronor. This meant that in the 30–52 000 kronor tax bracket taxable income rose by 120 % of the actual income increase. This intensified progression also applied to local income tax and was of particular importance in the event of increases in that tax; in the income brackets in question the effect of such increases is in the ratio of 1.2 for each percentage point by which local income tax is raised. This meant a perceptible strengthening of the marginal effects in this bracket in connection with the big rises in local income tax which were undertaken in 1971 and 1972. It even had the

effect that the absolute marginal tax rate in local government areas with high taxation became higher on incomes between 35 000 and 52 500 kronor than in the income bracket 52 500 to 70 000 kronor.<sup>8</sup>

### *The 1973 reform*

These progression effects, which particularly hit income-receivers in the 30–40 000 kronor bracket, also troubled the Government, according to a statement made by the Minister of Finance,<sup>9</sup> and proposals for an adjustment of the tax rates were made as early as 1972 (*Prop.* 1972: 95). The reform which would seem to be most appropriate would have been to relax the marginal tax pressure and eliminate the sagging in the elasticity curve which had produced the need for a modification. Such a reform, however, would benefit above all the higher-income-receivers, as only these would be in a position to enjoy the whole of the tax reduction. This would be in conflict with the distribution-policy considerations which formed the basis for the 1970 tax package.

For this reason the Government chose the line of reducing the tax payable in the brackets below 30 000 kronor of taxable income, i.e. about 35 000 kronor of assessed income, by three percentage points. As is revealed by the income distribution for 1973 shown in *Fig. 1* above, the great majority of incomes are to be found precisely in the brackets below 35 000 kronor and so this tax adjustment, which may perhaps seem relatively inconsiderable, nevertheless turned out to be costly for the Treasury. The amount of 2 400 million kronor which the reform cost the state was partly made up by raising the employers' contributions. This change gave most to those who had been worst hit by the progression effect of the system. Taxpayers in the 35 000–70 000 kronor bracket got a tax reduction of 900 kronor. For incomes in the 70 000–100 000 kronor bracket, the tax was raised by three percentage points in order that the top flight of income-receivers should not benefit from the reform. The result of the reform is shown in *Table 3*. As will be seen from that table, the changes had other effects, too. The tax reduction for those with taxable incomes below 30 000 kronor meant that the problem which had occasioned the need for reform was aggravated. The changed relation between average tax and marginal tax had the result that the income elasticity fell still further in precisely those areas that were particularly sensitive. The income elasticity was now only 5.5 at the 35 000 kronor income level. The possibilities of improved standards being achieved through an increase in income also diminished in all income

<sup>8</sup> Lodin, 1972.

<sup>9</sup> Sträng.

Table 3. *Income tax payable by married persons (sole earners in family) in 1973 (local income tax 23.94 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	14 %	12 950	35 %	7.6 %
20 000	19 %	16 150	40 %	7.4 %
25 000	24 %	19 100	46 %	7.1 %
30 000	27 %	21 800	54 %	6.3 %
35 000	31 %	24 050	62 %	5.5 %
50 000	41 %	29 700	62 %	6.4 %
75 000	48 %	38 850	71 %	5.6 %
100 000	54 %	46 150	73 %	5.9 %

levels above that figure—especially in the 70 000–100 000 kronor bracket. The taxation of incomes above that figure was not affected by the reform but instead changed as a result of the rises in local income tax. The marked intensification of progression at 70 000 kronor was undertaken not so much because such a step was considered desirable at that level of income as because it was desired to exclude people with incomes above 100 000 kronor from the tax reduction. For this reason it was necessary to raise the marginal tax rate for income recipients in the brackets below that level. The effect of the reform can be summarized very briefly in the following way. In order that recipients of high incomes should not benefit from the tax reduction for the broad groups of taxpayers the marginal effects in the system had to be intensified for the medium income groups. The position of the high-income recipients remained unchanged, whereas it became more difficult for the lower-income groups to raise their living standard through their own work output. The lock-in effects of the system were further intensified.

If the situation which arose in 1973 is considered from a practical point of view it will be seen that it meant that the strongest progression and lock-in effects of the tax system were felt in precisely those income levels that were characteristic for a large proportion of the wage-earning groups. In 1973 the average wage for industrial workers belonging to unions affiliated to the Swedish Confederation of Trade Unions was 32 400 kronor and already in 1971 more than 60 % of the members of the Swedish Central Organization of Salaried Employees had incomes above 30 000 kronor.

This meant that even at the moderate inflation rate of about 5 % which was prevailing at that time these groups would not be able to maintain an unchanged standard of living with an increase of 10 % in their earnings.



It was therefore obvious as soon as the tax reform had been decreed that a further reform would be necessary before the collective bargaining round of 1974 precisely because of the form taken by the change of 1973, characterized as this was by intensified lock-in effects in respect of sensitive income groups consisting largely of wage-earners.

### *The 1974 changes*

In the autumn of 1973 the Government introduced a bill containing the next reform. Under this measure the old-age pension contribution, which amounted to 5 % of taxable income up to 30 000 kronor for individuals aged 16–66 years, was abolished, while at the same time an extra national insurance contribution, payable by employers, was introduced (*Prop.* 1973: 144). The reform was directly linked to the collective bargaining round and had many advantages as part of the wage negotiations. Normally there are considerable problems involved in linking wage negotiations with tax reductions, owing to the fact that there are more than 1.5 million income recipients who are not employed. Any general reduction of taxes in exchange for lower wage demands would also benefit these groups of non-employed persons despite the fact that they would escape having to pay for the reform in the form of lower wage claims. General reforms also give rise to problems concerning high-income recipients, a category which, for reasons of distribution policy, it is not desired to favour.

If we regard the abolition of the old-age pension contribution on the basis of these considerations, the reform appears well founded. Thus the contribution was payable only by persons of working age and consequently a large group of income recipients who did not work were automatically excluded from the reform. Moreover, the contribution was payable only on incomes below about 35 000 kronor, which meant that, broadly speaking, it was only incomes from work which benefited from the reform, and the majority of income recipients of working age mainly have incomes from work even though they may also have some other income. Furthermore, the effect was that the reform meant a percentage wage addition for people with incomes below 35 000 kronor, while at the same time the marginal tax on the negotiated wage increase was reduced for these groups. For people with incomes above 35 000 kronor the reform represented an increase of a fixed amount.

As to the impact of the 1974 reform on the income-tax structure, the starting point was that the marginal effects and consequently the lock-in effects for important groups of wage-earners were so strong that it was considered necessary to undertake a modification of the tax system before

Table 4. *Income tax payable by married persons (sole earners in family) in 1974 (local income tax 24.03 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	11 %	13 350	32 %	7.6 %
20 000	16 %	16 800	36 %	7.6 %
25 000	20 %	19 950	43 %	7.0 %
30 000	24 %	22 850	49 %	6.6 %
35 000	28 %	25 300	63 %	5.1 %
50 000	38 %	30 800	64 %	5.9 %
75 000	47 %	39 800	71 %	5.5 %
100 000	53 %	47 100	73 %	5.8 %

the annual round of wage bargaining. The results of the reform, apart from the immediate tax reduction of up to 1 500 kronor, are shown in Table 4.

Against the background of the problems which produced the need for reform—the strong lock-in effects of the tax scale—the consequences of the reform were remarkable. The lowering of the average tax for all income recipients concerned meant, in combination with the unchanged marginal tax rate for taxable incomes above 30 000 kronor, that the relation between average and marginal tax was changed in such a way that the progressivity and the lock-in effects of the system were further intensified. This was particularly evident in the 30–50 000 kronor bracket, i.e. in the bracket where the broad groups of wage-earners were to be found. The income elasticity at an income of 35 000 kronor was only 5.1 % after the reform, against 5.5 % before it and 7.3 % in 1970. This meant that the possibilities for income-receivers in that bracket to improve their living standard by increased work inputs had fallen by one quarter since 1970 as a result of this reform.<sup>1</sup> If, moreover, we take account of the inflation rate of about 12 % which prevailed in 1974, the result was that in the ensuing year income increases of about 24 % would be required to retain an unchanged standard of living if no further tax reforms were undertaken. In the higher income levels the effects were not equally great. The gradual intensification of the levelling of taxation consequent upon the reforms of 1971–74 was thus greatest in the income levels around 35 000 kronor, levels where many important groups of wage-earners were represented.

<sup>1</sup> For families with children the effects have in fact been even more severe if account is also taken of housing allowances and the tapering off of these. See further on this L. Matthiessen, 1973, pp. 275 ff., 1974, p. 226. See also Lodin, articles in *Dagen*, *Nyheter* 1973, Sept. 6 and 12.

The conclusion from this is that the feature of the 1971 tax reform which together with the rises in local income tax led to the changes of 1973, and which was aggravated by the latter and consequently led to the 1974 reform, was aggravated still further by that reform and would therefore presumably lead to a need for yet another change—all this despite the fact that in the reforms of 1973 and 1974 the largest concession in terms of cash had been given to the groups most severely hit by the marginal effects. In this way the income taxation in Sweden had developed into a system of self-generating reforms. These effects of the change in the structure of the tax scale brought about by the 1971 reform become even more troublesome in the presence of steep inflation. Normally, a high degree of progressivity is regarded as valuable from the point of view of stabilization in a time of inflation, as it enables the state to mop up the money surplus which is created by the inflation. This, however, is only true in the case of demand inflation. Given the type of cost inflation—mainly due to international factors—that we have had, the high progressivity aggravates the effects of the inflation and is therefore not something that it is desirable to undertake in that connection. Nevertheless the situation has been that, precisely at the time when we have been exposed to extremely high inflation, we have retained an income-tax structure which is sensitive to inflation to a degree previously unparalleled.

#### THE PROBLEM OF INCOME EQUALIZATION IN A COUNTRY WITH A LARGE PUBLIC SECTOR

What then are the problems which have driven us into this unfavourable situation? Sweden has one of the highest tax pressures in the world—perhaps the highest of all. But it also has a very far-reaching ambition to bring about a levelling of incomes by way of taxation. This results in a conflict situation which is unique in its acuteness.

A strong and growing public sector must necessarily conflict with the citizens' desire for a rise in living standards in the form of increased disposable incomes. And if the policy of redistributing incomes is taken to great lengths, this, too, will run counter to the interest of income-receivers in having a greater disposable income, its effect being felt even far down in the income scale.

A large public sector is not in itself incompatible with a high degree of redistribution. But both of them conflict with the citizens' wish to see an increase in their incomes. In Sweden today this competition has become so

severe that the expansion of the public sector and the drive towards levelling of incomes can clearly be seen to be objectives which cannot both be achieved simultaneously without conflicts arising owing to the fact that the citizens' demand for a certain measure of individual raising of standards must be met.

As the general tax pressure must be high owing to the size of the public sector, it becomes necessary to have very high marginal taxes reaching far down into the middle income-brackets if it is to be possible to achieve perceptible redistribution effects by way of taxation. Where the tax pressure is low, a larger share of the tax revenues can be obtained from the higher income brackets, while at the same time it is possible to achieve redistribution with relatively moderate marginal tax rates. In such circumstances the lock-in effects are easier to endure because the extra taxation of the higher income brackets for purposes of redistribution makes it possible to alleviate the tax pressure in the lower income brackets and thus to give people with lower incomes a greater amount of disposable income. With a high tax pressure and an income distribution of the type prevailing in Sweden it is inevitable that the low- and medium-income recipients should have to bear the greater part of the tax burden. The shifting of the tax burden to employers which has occurred as a result of the changes of the 1970s does not alter this picture to any appreciable extent, as it is probable that the greater part of this shift is counterbalanced by a contraction of the scope available for wage increases. At the same time the steep progression produces very evident lock-in effects without bringing about any appreciable relaxation of the tax pressure for the lower income-brackets owing to the insufficient tax basis in the higher brackets. The demand for a levelling of incomes, moreover, means that the marginal tax rate has to be kept so high in all income brackets except the very lowest that it is felt to be confiscatory even—one might also say especially—by people in the lower income brackets. For this reason the levelling of incomes in a high-tax society has negative effects not only for those with high incomes but also for the broad groups of wage- and salary-earners. The higher the tax pressure is, the more difficult it will be to pursue a redistribution policy by way of taxation, owing to the troublesome lock-in effects. This is the paradox and the dilemma of the high-tax society.

The connection between redistribution, which is considered desirable and lock-in effects, which are considered to be undesirable, is indissoluble. The lock-in effects which were the consequence of the redistribution profile that characterized the changes of 1971 have not, however, been considered acceptable. A characteristic feature of the reform period 1971–74 has been that the Riksdag has tried to carry on redistribution

without having to take the consequences in the form of lock-in effects. They have tried to conceal the lock-in effects by means of the repeated tax changes, but the price for this is bound to be a still worse locking-in in the future. The consequences of the intensified redistribution profile which distinguished the 1971 tax changes can thus be seen to be a major cause of the frequent tax changes during the 1970s. Sooner or later, however, it will be necessary to adjust the income-levelling and the lock-in mechanisms to each other. On the assumption that in any case the state's need for revenue will not diminish, this can be done only in one of two ways. The politicians must resign themselves to lock-in effects as a result of the redistribution policy or, if these effects are considered unacceptable, they will have to content themselves with a lower measure of redistribution in the tax system.<sup>2</sup>

## THE TAX CHANGES OF 1975 AND 1976

### *The 1975 reform*

No more than a month had elapsed since the Government Bill for the 1974 reform—the abolition of the old-age pension contribution—was presented before the Government took the initiative for a new change as early as 1975. On October 12, 1973, the Royal Commission on Taxation which had been set up in 1972 received additional directives whereby it was asked to prepare proposals with the aim *inter alia* of mitigating the marginal effects for income recipients in the middle income levels.<sup>3</sup>

Thus even before the 1974 reform had entered into force the Minister of Finance was aware that it would not be possible to keep for more than one year the structure given to the tax rates as a result of the reform. This was nevertheless at a time when the rate of inflation was still under 5 %. It also emerges from the directives that the Minister considered the marginal effects of the system to be the worst problem and that the method which had been used in the 1973 and 1974 reforms was not considered suitable for the next change.

The Royal Commission, which put forward its proposals in March 1974, devoted a considerable part of its work to illustrating the combined marginal effects of, in particular, income tax and housing allowances. The commission also discussed in brief the elasticity of income after tax.<sup>4</sup> Its

<sup>2</sup> Lindbeck.

<sup>3</sup> *SOU* 1974: 20.

<sup>4</sup> *Prop.* 1974: 20.

conclusion was that the marginal effects, particularly for families with children in the middle income groups (30 000–50 000 kronor) and for old-age pensioners, were so considerable that they had to be alleviated. Thus in conformity with its directives the commission concentrated its proposals on this problem.

In the main the commission's proposals were embodied in the Government Bill submitted to the Riksdag in the autumn of 1974 following the inter-party agreement known as "Haga I" (*Prop.* 1974:132) and were approved by the Riksdag. The result of the change as far as taxes were concerned was mainly as follows. The health insurance contribution was abolished and was replaced by an increased social insurance contribution payable by employers, the tapering off of the basic allowance beginning with taxable incomes above 30 000 kronor was ended, the national income-tax rates were adjusted in order to reduce the marginal taxes especially in the middle income brackets and a so-called "special tax reduction" of 250 kronor was introduced for income-receivers over 16 having an income from work of at least 4 500 kronor and an assessed income not exceeding 36 000 kronor. The result of this was cuts for all persons with incomes below 190 000 kronor. In percentage terms the reduction was greatest for incomes up to 20 000 kronor. In cash terms it was greatest for incomes between 50 000 and 100 000 kronor. The reform was financed by raising the employers' tax liability in respect of manpower.

As to the effects of the main features of the reform, it can be established that in principle the abolition of the health insurance contribution was similar to that of the dropping of the old-age pension contribution in the previous year. In fact it was even more directly to the benefit of employees and was thus well adapted to being taken into account in the wage negotiations of 1975. The abandonment of the tapering-off procedure for the basic allowance, spelling as it did the end of an element in the 1971 reform which had proved troublesome from a number of viewpoints, benefited all taxpayers with a taxable income of more than 30 000 kronor and meant a considerable reduction in the marginal rate for incomes between 35 000 and 52 500 kronor. The introduction of the special tax reduction meant, however, new tapering-off problems which were solved only at the price of very strong marginal effects for those with assessed incomes between 36 000 and 38 500 kronor.

The effects of the reform for the group consisting of married persons with families can be seen in *Table 5*.

Average tax and marginal tax was reduced in all income levels below 75 000 kronor. The fact that the actual tax reductions were not greater is to be attributed to the relatively large increases in local income tax which



Table 5. *Income tax payable by married persons (sole earners in family) in 1975 (local income tax 25.23 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	7 %	13 900	32 %	7.5 %
20 000	13 %	17 350	36 %	7.5 %
25 000	18 %	20 550	41 %	7.2 %
30 000	22 %	23 450	46 %	6.9 %
35 000	25 %	26 150	57 %	5.7 %
50 000	35 %	32 700	63 %	5.7 %
75 000	44 %	41 700	73 %	4.8 %
100 000	52 %	48 400	75 %	4.8 %

were introduced at the same time: in 1975 this tax was raised to 25.23 % as compared with 24.03 % in 1974 (national average).

In percentage terms the reduction of average tax was greatest in the lowest income brackets, while the largest reduction in marginal tax occurred in the 30–50 000 kronor bracket. The changed relations between average tax and marginal tax meant in addition changes in the elasticity of income after tax. The levelling effect continues to be powerful throughout the entire income scale. Even in the lowest income brackets it is as severe as it had been at the 50 000 kronor level in 1970. The striking unevenness of redistribution, whereby the levelling and lock-in effects were most severe at the 35 000 income level, has been eliminated. Now the degree of redistribution increases continuously with rising income. This has been achieved by mitigating the levelling effect for incomes between 25 000 and 50 000 kronor, while at the same time intensifying it considerably in the highest income brackets.

As regards the levelling between lower- and higher-income-receivers, the reform involves a reduction of the levelling effect. If, for example, we compare a person with a gross income of 25 000 kronor and one who receives three times as much, i.e. 75 000 kronor, we find that whereas in 1974 the high-income-receiver could keep 1.99 times as much of his income after tax as could the low-income-receiver, in 1975 he could keep 2.03 times as much.

Thus the change meant both considerable tax reductions and improved possibilities of increasing disposable income for the broad groups of wage- and salary-earners. The marked lock-in effects, aggravated by the inflation, were mitigated. In contrast to the earlier reforms of the 1970s, the changes introduced in 1975 meant, therefore, that the Government had

tried to deal with those elements of the tax system which had given rise to the need for reform.

### *The 1976 reform*

On October 9, 1974, the very day on which *Prop.* 1974: 132 concerning the tax changes for 1975 was submitted to the Riksdag, the 1972 tax commission referred to above once more received supplementary directives calling upon it to prepare proposals for tax changes applicable to 1976 incomes in order to facilitate the conclusion of a two-year settlement in the wage negotiations of 1975. The commission was asked to direct its proposals to a relaxation of taxation above all for low-income-receivers together with the broad groups of wage- and salary-earners.<sup>5</sup>

As regards the tax reforms of 1973 and 1974, it is clearly evident that the structure of the tax rates, characterized as it was by the occurrence of the severest levelling and lock-in effects precisely in those income brackets occupied by large groups of wage-earners, had made it necessary to undertake changes, quite apart from the factor constituted by the rate of inflation. After the 1975 reform, however, the tax-scale structure was such that, despite its high redistribution profile, it would probably not have had to be subjected to immediate revision had not the rate of inflation been so high.

The reform for 1976 which was adopted by the Riksdag in its spring session consisted in the main of an adjustment of the tax scale whereby the amount of tax payable was reduced by varying percentages at all levels below 35 000 kronor of taxable incomes and was raised by one percentage point for taxable incomes above 80 000 kronor. In percentage terms the reduction is greatest for incomes up to about 40 000 kronor. In cash terms it is greatest—1 600 kronor—in the income brackets 40 000 to 85 000 kronor.<sup>6</sup>

For those with incomes below 40 000 kronor the change thus means a reduction in both average and marginal taxes, for those receiving between 40 000 and 85 000 kronor it means reduced average tax and unchanged marginal tax, and for those receiving more than 85 000 kronor it means a reduction in average tax but an increase in marginal tax. Thus the changes involve an intensification of levelling effects but also of lock-in effects for incomes from about 40 000 kronor upwards.

The effects of the 1976 tax changes in so far as "sole breadwinners" are concerned are shown in *Table 6*.

All recipients of incomes up to 35 000 kronor have been given, in

<sup>5</sup> *SOU* 1974: 103.

<sup>6</sup> *Prop.* 1975: 92.



Table 6. *Income tax payable by married persons (sole earners in family) in 1976 (local income tax 25.73 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	7 %	14 000	29 %	7.6 %
20 000	12 %	17 550	29 %	8.1 %
25 000	16 %	21 050	35 %	7.7 %
30 000	19 %	24 350	46 %	7.7 %
35 000	23 %	27 050	53 %	6.0 %
50 000	32 %	33 800	64 %	5.3 %
75 000	43 %	42 600	74 %	4.6 %
100 000	51 %	49 050	77 %	4.7 %

addition to the net tax reduction, substantially increased possibilities of enjoying a net income increase. The levelling and lock-in effects in these income brackets have been further mitigated. In higher income brackets, on the other hand, these effects are intensified. The intensification is most marked for incomes between 50 000 and 75 000 kronor.

In order to arrive at a correct evaluation of the outcome of the 1976 tax change it is necessary, owing to the high inflation rate, to relate this to the income distribution which can be expected for 1976. The 1972 commission presented in its report an estimated income distribution for 1976 based on an estimation of the way in which the income distribution for 1972 would develop.<sup>7</sup>

Although the calculations are uncertain and the estimates are probably too cautious, it emerges from the commission's forecast of incomes that at least 40 % of all income recipients and 60 % of all income recipients in full-time employment are envisaged as having incomes exceeding 40 000 kronor. In the case of incomes above 50 000 kronor the estimated figures are 24 % and 45 % respectively. For incomes of 70 000 kronor the corresponding figures are 8 and 14 %. Where "sole breadwinners" are concerned these figures will probably be higher.

The result is thus that the progression and consequently the lock-in effect are intensified precisely in those income levels which contain nearly half of all income-receivers and which embrace the majority of all income-receivers in full-time employment. For these groups the lock-in effect prevailing immediately before the wage negotiations of 1977 is as strong as or stronger than that which arose after the 1974 reform and which led to

<sup>7</sup> SOU 1974: 103.

the changes of 1975. Once again, therefore, there has been an intensification of the very element in the tax-scale structure which has caused problems throughout the 1970s. The commission claimed in its report that its aim had been to choose a simple method for making the necessary adjustments and that so far as possible it had tried to avoid making pronouncements on questions of principle which might conceivably tie the hands of those engaged in further work on tax problems.<sup>8</sup> Nevertheless there can be no doubt that the structure of the 1976 reform gave rise to new and serious problems in the work on a 1977 tax reform.

### COMBINED EFFECTS OF THE 1971-76 REFORMS

So far we have dealt with the changes in income taxation which have been brought about by the various reforms in turn. It may, however, be of interest to consider briefly the combined effects of the changes over the whole period. The change in the average tax payable in different income levels between 1970 and 1976 is shown by the curves in *Fig. 4*.

The successive reductions of national income tax during the period, totalling close on 20 000 million kronor, have meant that the average tax has been reduced in all income levels except the very highest, despite increases in local income tax amounting to nearly 5 percentage points. The reduction in national income tax is especially marked in the lowest income brackets. It is greatest at about 15 000 kronor, where the tax has been reduced by as much as 16 percentage points, but at the 40 000 kronor income level the reduction is still 8 percentage points. Thus, taken as a whole, the tax changes have had a pronounced low-income profile.

The comparison between the taxation in 1970 and 1976 will not, however, be just unless we also take into account the very high inflation which characterized the period and in particular its latter part. On January 1, 1970, the consumer price index was 228 units. By January 1, 1975, it had risen to 331 units.<sup>9</sup> If for 1975 we take as our starting point the very cautious estimate of a price rise of about 8 % made in the Finance Bill in that year, it gives for January 1 an index figure of 358 units, i.e. an increase of the index from 1970 to 1976 by 57 %. If we recalculate 1976 incomes taking this into account, the picture is drastically changed. For this reason

<sup>8</sup> *SOU* 1974: 103.

<sup>9</sup> Statistiska centralbyrån.

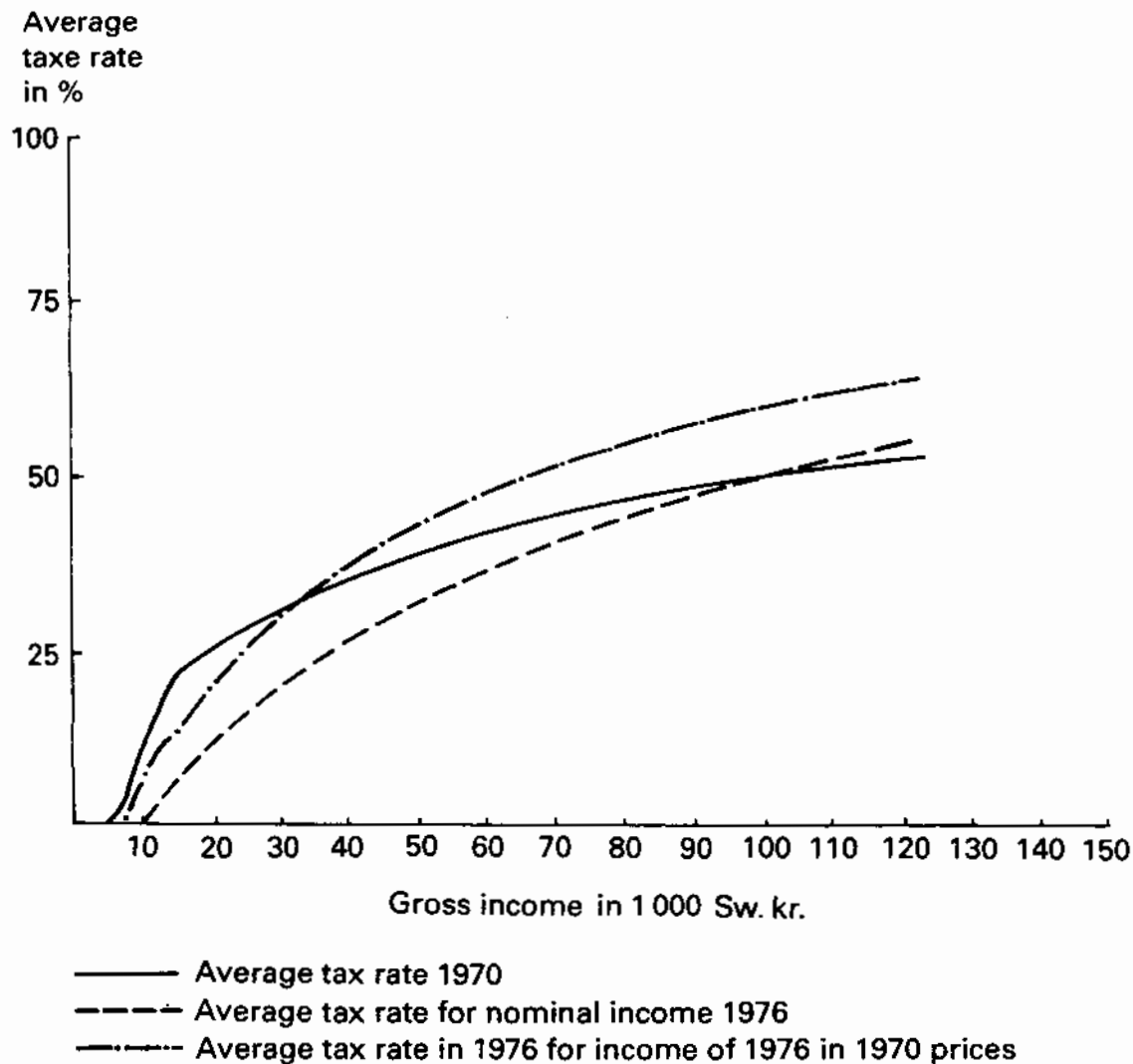


Fig. 4. Income tax for married persons (sole earners in family) 1970 and 1976.

the average tax paid on incomes during 1976 has been recalculated in 1970 prices.

It can be seen from the figure that the amount of income tax paid, where the income has been recalculated in fixed prices, has fallen between 1970 and 1976 only for those receiving incomes below 30 000 kronor in 1970 prices (corresponding to a nominal income of 47 100 kronor in 1976) and even so is not of a substantial amount except in the 10–20 000 kronor income bracket. On the basis of the above-mentioned estimated income distribution for 1976, however, this nevertheless turns out to mean that at least 70 % of all income-receivers had had a tax reduction in real terms during the period. Other income recipients had had their tax burden increased. It also emerges that more than half of all income-receivers in full-time employment in 1976—irrespective of marital status and family responsibilities—had suffered an increase in tax pressure instead of a reduction; this is shown by comparing the tax payable on nominal income.

Table 7. *Net income increase after tax from 10 % gross income increase in 1970 and 1976*

Income (1)	Net income increase after tax			1970 income acc. to col. 1 corresponds to a nominal income in 1976 of (5)
	1970 (2)	1976 (3)	1976 in 1970 prices (4)	
15 000	8.3 %	7.6 %	7.9 %	23 550
20 000	8.5 %	8.1 %	6.8 %	31 400
25 000	7.8 %	7.7 %	6.5 %	39 250
30 000	7.8 %	7.7 %	5.4 %	47 100
35 000	7.3 %	6.0 %	5.5 %	54 900
50 000	7.5 %	5.3 %	4.6 %	78 500
75 000	7.0 %	4.6 %	4.7 %	117 750
100 000	6.9 %	4.7 %	4.4 %	157 000

In fact the real tax pressure for employees may be said to have risen still more, if we also take into account that part of the increase in employers' contributions during the period which was directly linked to the income-tax reductions and was aimed at reducing the inflation rate. The income-tax reductions of 1974, 1975 and 1976 were directly linked to such increases, amounting in all to about 14 %. As the reductions were financed mainly through increased employers' contributions the employees have thus also indirectly played a part in financing the tax reductions for other income-receivers.

The development of the elasticity of income after tax is also worth studying in the same way. It is illustrated in *Table 7*.

If we compare the elasticity of income on the basis of the taxation of the nominal income during the two years it will be seen that in percentage terms the net income increase has been reduced for all income-receivers, i.e. the progression and consequently the levelling and lock-in effects have been intensified in all income levels, the intensification being particularly evident for incomes of 35 000 kronor and upwards. Already at 35 000 kronor the progression is steeper than it was at 100 000 kronor in 1970. If the same comparison is made with the income expressed in 1970 prices, these effects are still further accentuated. In 1976 the progression and the lock-in effect are more severe at an income corresponding to 20 000 kronor in 1970 prices than they were in 1970 at an income of 100 000 kronor.

Thus, by way of summary, it may be said that during the period studied, 1970–76, the nominal income tax paid was reduced in all income levels except in the case of incomes above about 100 000 kronor. The amount of

real income tax paid, however, was reduced only for those income-receivers who in 1976 had incomes below 30 000 kronor in 1970 prices. As far as the majority of income-receivers in full-time employment were concerned the tax paid in real terms increased. The levelling and lock-in effects were intensified in all income levels. Calculated on the basis of the real tax yield these effects were intensified by 17 % at an income corresponding to 20 000 kronor in 1970 and by 31 and 39 % at incomes corresponding to 30 000 and 50 000 kronor in 1970. This very marked intensification took place simultaneously with an extremely high inflation rate, which further accentuated the effects. Against this background it is scarcely surprising that income tax has become so unpopular despite nominal income-tax reductions totalling nearly 20 000 million kronor during the period 1970–76.

Despite the fact that in Sweden the authorities pursue a very conscious redistribution policy with the aid of taxation, the noticeable intensification of the levelling effect in income taxation which continued to occur even after the 1971 reform is not mainly to be seen as the result of a deliberate levelling policy but as a consequence of the rapid succession of short-term tax reforms undertaken with the aim of momentarily mitigating the lock-in effects inherent in the system. It is therefore uncertain whether the degree of redistribution now prevailing can be said to express the politicians' view of the situation. At any rate they have not chosen to accept the consequences of the redistribution.

### THE 1977 REFORM

The tax changes discussed above were all undertaken by the former Social Democratic Government. The parliamentary elections of 1976 brought about a change of administration.

The adjustment of the tax scale for 1977, which was decided upon in the autumn of 1976, on the proposal of the new, non-Socialist Government, does not involve any considerable changes in the redistribution profile of the scale (see *Table 8*), despite the fact that the loss of revenue due to the change amounts to about 6 500 million kronor and the maximum reduction of taxes to 2 350 kronor. Although the marginal tax cuts made occur higher up in the income brackets than had been proposed by the former Social Democratic Government in the spring of 1976 after discussions with the major organizations of wage- and salary-earners, the proposals of the non-Socialist administration are based on those of its predecessor. The need for further changes remains. The reform of 1977 has indeed been described as a provisional step.

Table 8. *Income tax payable by married persons (sole earners in family) in 1977 (estimated local income tax 26.83 %)*

Income before tax	Average tax rate	Income after tax	Marginal tax rate	Net income increase after tax from 10 % gross income increase
15 000	7 %	14 000	29 %	7.6 %
25 000	16 %	21 000	33 %	8.0 %
35 000	21 %	27 500	49 % <sup>1</sup>	6.5 %
50 000	30 %	35 000	62 %	5.4 %
75 000	42 %	43 800	75 %	4.3 %
100 000	50 %	50 000	78 %	4.4 %
150 000	60 %	60 200	83 %	4.2 %

<sup>1</sup> Not taking into account the effect of the special tax reduction of 250 kronor.

## THE FUTURE

The 1972 tax commission is continuing to work on a more long-term reform of the income tax system. The problems here discussed form only a part of that task, albeit a difficult part. The change of government has to some extent brought new conditions for the commission's work. Thus, additional directives issued to the commission call upon it to formulate proposals for indexation of the tax scale, whereas the commission's earlier mandate did not permit it to do this.

The question of indexation of the tax scale is, properly speaking, a technical one. Indexation cannot bring about anything beyond what can also be achieved by annual political decisions. The discussion on this matter in Sweden has, however, come to bear the imprint of the divergent fiscal aims of the different parties. It would seem that there are no insuperable objections on redistribution grounds to an index system as such. In the first place, proper consideration can be taken of redistribution policy when formulating the index system. Even if this is not done, the most generally discussed form of indexation, whereby the tax scale is adjusted every year in conformity with the change in the consumer price index, means nothing more than that the real redistribution profile possessed by the tax system in a certain year is retained in the following year as well. If this effect is unacceptable it also means a rejection of the redistribution profile of the previous year.

Indexation does not in itself mean that the levelling and lock-in effects of the system diminish, except in those respects where this is intended. If an index is geared to the development of inflation it will only be the inflation-conditioned part of the increase of income which will be ex-

empted from the effect. If the linkage is to the outcome of the wage-bargaining round—for example to the average wage and salary increase for the broad groups of wage- and salary-earners—it will only be the increase due to this bargaining which will in principle be exempted from the stepping up of taxation. This is a possibility which should appeal to the trade union movement, as such a procedure would restore to the collective bargaining system the determinative role for the real income development of the wage-earners which during the 1970s has been taken over by the tax changes.

Thus, indexation will not resolve the conflict between redistribution and locking-in and does not, properly speaking, involve the taking up of a stance on the redistribution issue. In the budget proposals put forward in 1977<sup>1</sup> the Government, however, puts forward guidelines for tax policy in the longer term. Against the background of the cost-increasing effect of progression, the Government considers it necessary to reduce the marginal taxes in the ordinary income levels. As an example of this effect it is pointed out that a net wage increase after tax of 100 kronor given to an employee in the normal wage level will result in a cost increase of 360 kronor for the employer. A downward adjustment of the lock-in and the cost-increasing effects means at the same time that the politicians have had to content themselves with a lesser measure of redistribution in income taxation. Thus the Government has chosen to adjust the redistribution effect of the system to the degree of locking-in which can be accepted.

It is, of course, possible to have different opinions on what is the most suitable measure of distribution. The imbalance which characterized the income tax system during the 1970s owing to the lack of accord between redistribution aims and the degree of lock-in effects which has been considered acceptable is, however, mitigated as a result of this type of change. This imbalance is one of the most important reasons for the many tax changes of the 1970s. If the two sides of redistribution policy can be brought into harmony, this probably also means that we are about to enter on a new phase of development of the tax system and will be able to look on the changes of 1977 as the end of an epoch in Swedish fiscal history.

When judging the redistribution effects of income taxation, it is important to remember that levelling of incomes by way of taxation is a political instrument of a highly general character. If the effects are to be those which are desired, it is a prerequisite that the groups which it is intended to favour or disfavour through the tax system shall be more or less uniformly composed as regards their taxpaying capacity. One of the

<sup>1</sup> *Prop.* 1976/77: 100, appendix 2. Scandinavian Institute for Scandinavian Law 1957-2009



distinctive features of the tax reforms of the 1970s is constituted by the large tax cuts for low-income-receivers which have been made at the cost of considerable losses of revenue for the state. The income statistics indicate that the composition of this large group of people is very heterogeneous. In many cases their low taxable income bears no relation to the situation of low-income-receivers in general. The question is whether the general tax subsidization of low-income-receivers is not too blunt an instrument of support. A change-over to other forms of subsidies, directly addressed to those groups within the category of low income-receivers who need such help, would release the tax system from a function which, properly speaking, is alien to it and which, even apart from its high costs, complicates the difficult problems of evaluation and balancing that are inseparable from the framing of tax scales to such an extent that it becomes almost impossible to find a solution.

The majority of the ideas for new tax systems which have been put forward during recent years have, consciously or unconsciously, been rooted in the lock-in effects that are inherent in the markedly redistribution-orientated nature of taxation. The proposal for a progressive tax on manpower aims, among other things, at eliminating the "powerful negative psychological effects"<sup>2</sup> of progressivity. However, it is probable that a system in which the wage-earners negotiate on net earnings and the employers on gross costs tends to emphasize the differences between the percentage increase of net earnings and gross earnings, thus making the lock-in effects more obvious to the wage-earners and leading to higher wage demands than does the present system, where the wage-earners are in part probably dazzled by the high figures of the gross wage increases. Other proposals, too, aim in fact chiefly at veiling the lock-in effects but lead nevertheless in the same way as the reforms of 1973, 1974 and 1976 to increasingly strong lock-in effects.<sup>3</sup>

If it is desired to bring about a levelling of incomes through taxation, it is not possible to avoid the lock-in effects by changing the tax system. The link between redistribution and locking in is indissoluble, irrespective of the form of tax.

<sup>2</sup> Olhede.

<sup>3</sup> See, e.g., the so-called "Metallförslaget" (Edin-Larsson, 1973*a, b*), proposals put forward by Larsson and Edin, two economists on the staff of the Metal Workers' Union, and the proposals for a tax reform in "Löner priser skatter", Rapport till LO-kongressen 1976 ("Wages, Prices, Taxes", Report to the congress of the Confederation of Swedish Trade Unions, 1976).