Building up Tax Systems: Lessons from the Nordic Countries

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Outline

Motivation

- Developing countries like Mozambique need to raise a sufficient amount of revenues to finance poverty reduction and to fight inequality
  - How could their tax capacity be improved?
- Nordic countries, in turn, have very high tax/GDP ratios – some would say too high
  - Conventional economics: heavy tax burden creates distortions to the economy (savings, employment reduced)
  - How can these countries still maintain high income levels?

The purpose of this talk

- Review briefly some key features of the tax structure and tax systems in Nordic countries
  - To understand how taxes can be so high in the Nordic countries
  - To provide food for thought for reforming tax systems in developing and emerging economies
    - Especially if and when these countries aim to increase their tax revenues
  - Much of the material draws on recent survey by Kleven (2014)
- Discussion:
  - can these tax solutions be exported?
  - should they be exported?

Outline

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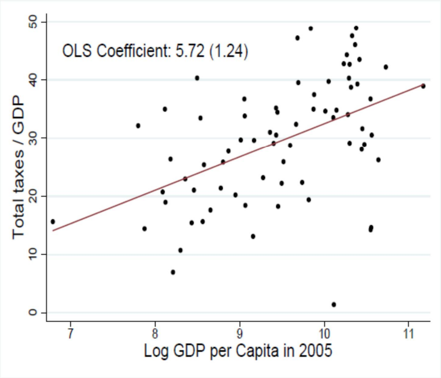
Well-known correlation (Source: Kleven, Kreiner, and Saez 2014)

Figure 1: Tax Take and Tax Structure Across Countries

A. Total Tax Revenue to GDP



Tax take is increasing (by income groups)

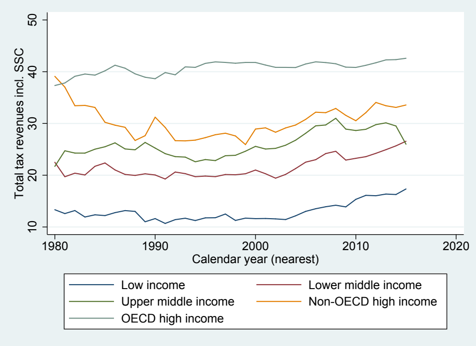


Figure: Revenue (including SSC but excluding grants). Own calculations using the GRD of UNU-WIDER

Tax take is increasing (by regions)

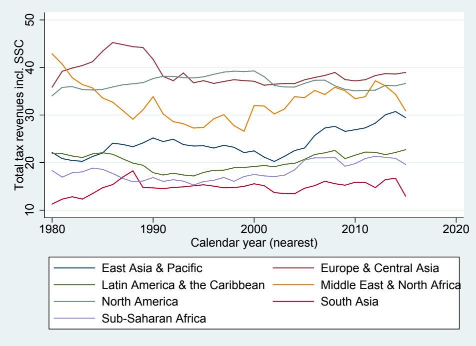
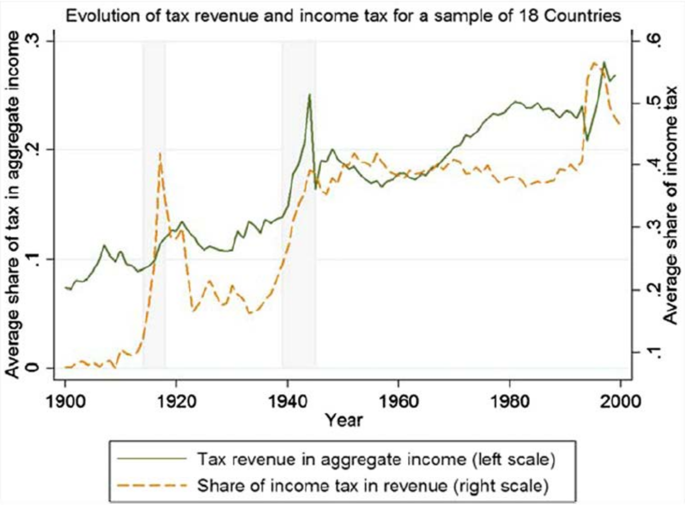


Figure: Revenue (including SSC but excluding grants). Own calculations using the GRD of UNU-WIDER

Rich countries tax rate was also small (Source: Besley and Persson 2013)



Comparison of tax revenues

	Total rev	PIT	CIT	All indirect	G&S	Trade
Finland	54	26	2	15	15	0
Norway	55	21	2	11	11	0
Sweden	50	23	3	12	12	0
OECD high income	43	19	3	11	11	0
Mozambique	26	3*	6*	13	9	2
Sub-Saharan Africa	20	4	3	10	7	2

Table: Tax revenues as a share of GDP, 2015. Source: GRD and own calculations (* indicates an estimate)

Outline

1. Broad tax base

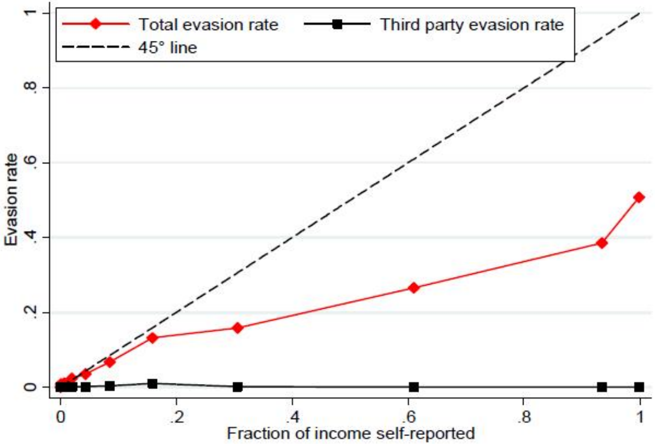
- The reaction of taxable income to changes in the tax rate is a good way of measuring the overall distortions of taxes on the economy
- Economists typically measure this as a elasticity (ETI):
  - It is defined as the proportional change in taxable income when the take-home part (1-marginal tax rate) of income is increased by 1 per cent
- US estimates between 0.2-0.5. The response of broad income less than that of taxable income
- Some evidence that ETI is lower in Nordic countries (Kleven and Schultz, 2014; Matikka, 2017)
- In addition, the difference in the elasticity of broad income and taxable income is smaller, reflecting wider tax base

2. Third-party reporting

- In the Nordic countries, extensive third party reporting regarding not only labour income, but also on many deductions and items of capital income
- Kleven, Knudsen, Kreiner, Pedersen, and Saez (2011) show that there is virtually no tax evasion for items that are third party reported
  - Whereas there is significant tax evasion on self-reported parts of the tax bill
- Third-party reporting crucial for minimizing tax evasion. The key question is how to achieve it in developing countries

Evidence on evasion from Denmark (Source: Kleven, Knudsen, Kreiner, Pedersen, and Saez 2011)

Figure 1: Evasion by Fraction of Income Self-Reported

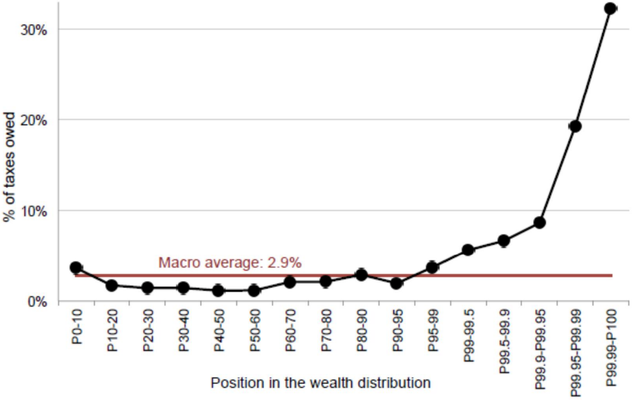


International tax evasion and the Nordic countries

- Alstadsaeter, Johannesen, and Zucman (2017) study how individuals from three Nordic countries (Denmark, Norway, Sweden) evade taxes using tax havens
- They are able to do so by combining leaks information (like the Panama papers) with data from revenue authorities
- They show that there is a strong gradient in wealth
- This information has not been (before) reported by third parties

International tax evasion from the Nordic countries

Figure 1: Taxes evaded as a % of taxes owed, by wealth group

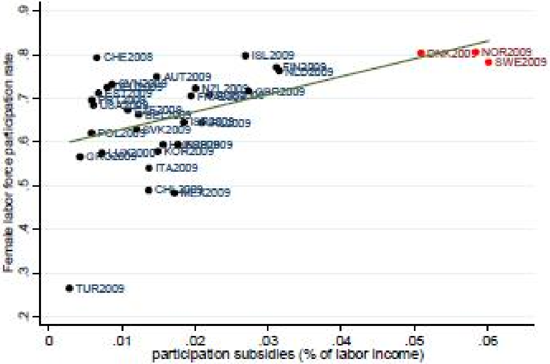


3. The role of the expenditure side

- Conventional economic theory stresses the harmful consequences of labour income tax burden on employment and working hours
  - That view abstracts completely from the expenditure side
- The Nordic counties spend a sizable share of their expenditure on uses that support employment
  - Directly via services such as day care (enables participation of both parents)
  - Indirectly via universal health care and education which foster increases in skills
- Both theoretically (Blomquist, Christiansen, and Micheletto, 2010) and empirically verified that this policy reduces the distortions of taxation on employment

Fostering labour force participation

Panel D: Female Labor Force Participation Rate vs Participation Subsidies



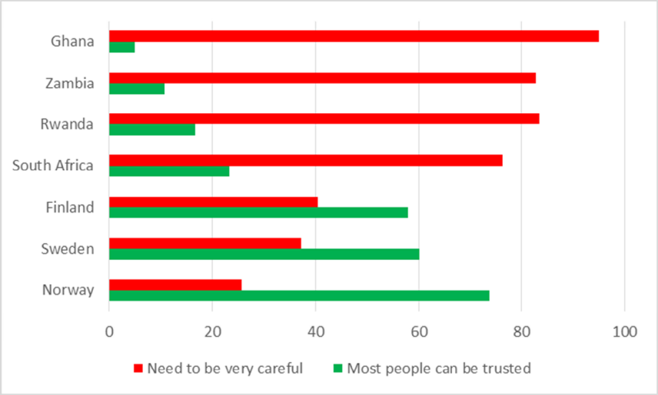
4. The role social norms

- Scandinavians have a stronger-than-average-trust on others, and enjoy high levels of social capital (measured by civic participation and voter turnout)
  - correlated with willingness to pay for public goods and can matter for tax compliance
- They also believe that poverty is not predominantly due to laziness of the poor but rather a results of a bad luck
  - this creates support for redistribution as the poor are seen as deserving
- These are strong correlations, but probably jointly determined
  - e.g. easier to trust others in a well-functioning state

Trust on others

- Data from World Values Survey, latest two waves
- Question:
  - "Generally speaking, would you say that most people can be trusted or that you need to be very careful in dealing with people?"
- Choices:
  - Most people can be trusted
  - Need to be very careful
  - No answer
  - Do not know

Trust on others, Source: WVS



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Summary: 4 key messages

- Building up a broad tax base is needed to keep tax distortions and avoidance at bay with increasing tax rates
- Extensive 3rd-party reporting is essential for reducing tax evasion
- The effects of taxation are *not* independent of how the money is spent: social programmes that boost labour force participation help reduce tax distortions
- Social norms and government structure intertwined

Final thoughts

- The small size, relatively homogenous populations and highly educated workforce make the Nordic countries special
- The Nordic model is not (and should not?) be directly exported to other settings.
  - to illustrate, just increasing the tax take without improving the quality in public services not necessarily a good idea
- However, some of the solutions in the Nordic countries provide food for thought for other countries in thinking about tax reforms

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