Building up Tax Systems: Lessons from the Nordic Countries

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Embassy of Finland and UNU-WIDER Seminar, Maputo, 7 July 2017
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Introduction

Some data about taxation

Key features of Nordic tax systems

Conclusions
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?
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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

OLS Coefficient: 5.72 (1.24)
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

<table>
<thead>
<tr>
<th></th>
<th>Total rev</th>
<th>PIT</th>
<th>CIT</th>
<th>All indirect</th>
<th>G&amp;S</th>
<th>Trade</th>
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<tr>
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<td>19</td>
<td>3</td>
<td>11</td>
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<tr>
<td>Mozambique</td>
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<td>3*</td>
<td>6*</td>
<td>13</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>20</td>
<td>4</td>
<td>3</td>
<td>10</td>
<td>7</td>
<td>2</td>
</tr>
</tbody>
</table>

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

Macro average: 2.9%
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
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 result 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

![Graph showing trust levels in different countries.](image)
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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.
References I


