Globalization and Taxation: Challenges to the Swedish Welfare State

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One of the most widely debated issues in comparative political economy today is the globalization thesis. Taxation is at the center of this debate. According to this thesis internationalization increases the availability of the exit option accorded mobile asset holders and this in turn forces policy makers to compete for transnationally fluid investment via tax reductions. The result, proponents of this view argue, is that all nation states must redesign their tax systems - and most probably reduce tax burdens - in order to effectively compete in the new world economy. The result, many argue, will be an erosion of the fiscal capacity of the state which will ultimately undermine the welfare state. As Guttorm Schjelderup has written, The fear is that capital mobility may lead to capital flight from high to low tax countries in such large amounts than it deprives a nation of its tax base and, as a consequence, its welfare system (Schjelderup 1993: 377).[1]

Not all analysts agree however. On the other side of the 'globalization' argument are a group of political economists who emphasize the institutional and political constraints countervailing the international competitive pressures which presumably push all countries towards the bottom. Garrett and Lange, for example, have argued that domestic institutions as well as demands for increased social protection in the face of international economic competition mitigate against the pressures to reduce the size of the welfare state (Garrett and Lange 1991; Garrett and Lange 1995: 628-9). Similarly, Fritz Scharpf has written national welfare states differ greatly in their vulnerability to international economic pressures, and in the specific problems which they need most urgently address -- and they differ also in the policy options that they could reach under the path-dependent constraints of existing policy legacies, and under the institutional constraints of existing veto positions. (Scharpf 2000: 224).[2]

The following analysis aims to enter this debate through an examination of the political economy of taxation in Sweden. Sweden provides and excellent case to study this New Political Economy of Taxation for several reasons. First, Sweden is one of the most heavily taxed countries in the world. Second, Sweden has long been a relatively open economy. Third, Swede s have long been noted for (and proud of) their commitment to a broadly redistributive welfare state.[3] Finally, early in this decade (1991) Sweden introduced a massive tax reform that it dubbed The Tax Reform of the Century which was widely held up to be, the most far-reaching tax reform in any western industrialized country (Agell, Englund, and Södersten 1996: 643). This reform not only followed the general pattern of tax reform witnessed in a wide variety of countries in the 1980's and 1990's (cf. Pechman 1988; Sandford 1993; Tanzi 1995), but actually went further in reducing marginal tax rates and broadening the tax base than similar reforms in many other countries.

This case study, then, offers a test of the Globalization thesis in terms of its expectations for what should happen to tax policy in the face of globalization and provides a more subtle analysis of the actual changes in tax policy which actually have been implemented in recent years.

To preview our findings a bit: First, I find on the one hand that the fear that globalization should create an End of the State to be grossly overstated. This does not mean, however, that we find no changes in tax policies in Sweden. Indeed, the evidence suggests that Sweden, and even more broadly, The Swedish Model has changed quite dramatically since it was first heralded as The Middle Way between free market capitalism and state dominated socialism. Tax policy is most certainly adapting to the new political economic realities at centuries end. Interestingly, however, this case study evidence suggests neither The End of Redistribution (Steinmo 1994) nor that There Is No Alternative (TINA) as Mrs. Thatcher was so often fond of saying. Instead, it appears that the Swedes are continuing their historical pattern of manipulating some kind of middle ground between the rampant liberalism of free markets, and controlled markets in the hands of a large and powerful state. Swedish tax policy is adapting to the realities of the New Political Economy, but the Swedish welfare state is not dying because of it.

The Old Political Economy of Taxation in Sweden

Sweden has long been noted, admired and loathed as the premier example of a high tax high spend Social Democratic State. With a Socialist party in office for all but 9 years since 1932, this country has developed a highly redistributive and very expensive social welfare system that, to the surprise of many, has been remarkably economically effective for most of this period.[4] This Swedish Model depended rather fundamentally on a particular tax regime that on the one hand, taxed personal income, consumption and wealth very heavily. But on the other hand, capital and corporate income was remarkably little taxed in comparative perspective. This seemingly curious outcome (a Left dominated polity with highly redistributive policy ambitions constructing a tax system that taxed labor income more heavily than capital and corporate income) can explained in two different ways. First, there was specific Historic Compromise over tax policy between the Social Democrats and big employers over how far labor would press its anti-capitalist ambitions.

Second, throughout the post-war period a huge number of specific tax incentives were introduced which slashed effective tax rates paid by corporations who invested in the Swedish economy (Norr, Duffy, and Sterner 1959).

Though marginal tax rates were quite high, Swedish Ministry of Finance officials had become very accomplished in creating tax expenditures designed to direct investment to particular sectors of the economy, promote employment, and/or encourage investment (or build up stock reserves) during economic downturns (Hansen 1969).[5] The effects of these multiple and very deep tax incentives was that large Swedish corporations paid only nominal taxes on corporate profits.[6]

While large corporations and wealthy capitalists paid relatively low taxes (as long as they kept their capital in productive assets in Sweden) smaller, privately held firms and ordinary workers paid extraordinarily heavy tax burdens.[7] Though rarely publicly stated, the explicit corporate tax policy goal of the Social Democratic governments in the post-war years was to squeeze capital into the large, internationally competitive manufacturing industries. At the same time, Sweden maintained an open international trade policy which was explicitly aimed at forcing Swedish firms to maintain international competitiveness. These firms were, of course, precisely the firms dominated by LO unions, (Sweden s large centralized union organization) and were also the same firms had by now developed a working relationship with Social Democrats in classic corporatist arrangements.

Tax policy was thus fundamentally intertwined with what was widely known as The Swedish Model. In this model, personal income and consumption was very heavily taxed, where as capital income and profits were taxed quite lightly. This system was specifically designed to help concentrate capital and labor resources into Sweden's large internationally competitive manufacturing sector (Elvander 1972; Rodriguez 1980; Steinmo 1993). These industries, it should not go without notice, were also those most heavily represented at the elite levels of both the Swedish Employer's Federation (SAF) and Sweden's largest union confederation (LO) (Rothstein and Bergström 1999; Swenson 1989).

The post-war compromise in Sweden can be represented as a deal between labor, capital and the Social Democratic government in which capital would not only be allowed to coexist even while Socialists were in power (Pontussen 1986), but the Socialists and their labor union allies would conduct wage strategies[8] and tax policies that would explicitly favor corporate capital (Steinmo 1988). The other side of this corporatist deal was that big unions and a big state would also be tolerated, employment would be held at very high levels, and when economic change was called for, the individual worker and his family would be fully compensated for economic costs of structural transformation (Swenson 1989). Specific policies favoring unions were also introduced[9] and wide variety of public insurance, education, and welfare programs were established and expanded (Rothstein 1988).

It is in this context that one must appreciate the extent to which Swedish economic and policy elites became increasingly confident of their ability to manage the economy towards high growth, high per capita GDP, and a relatively egalitarian distribution of income. They were, perhaps quite justifiably, very proud of themselves and very confident of their abilities to manage capitalist development.[10] By virtually all accounts, the system worked. By the 1970s Sweden had become one of the richest countries in the world and had done this while building one of the most egalitarian society in the western world (Palme 1993). Swede s were unmistakably proud of this fact and admired themselves for having achieved very high levels of economic growth *and* high levels of economic justice (Heclo and Madsen 1987).[11]

In sum, by many accounts Sweden had achieved the best of many worlds by the mid 1970s: This small country in the north of Europe had one of the most egalitarian systems in the world, had essentially eliminated poverty, and educated one of the most dynamic, and flexible workforces found in any capitalist economy. At the same time the economy was quite productive, efficient, dynamic and dominated by major internationally competitive firms such as Volvo, ASEA and Eriksson. Finally, the government was democratic, highly stable, efficiently run by a well trained and well insulated technocratically oriented elite that possessed an arsenal of policy devises designed to keep the Swedish economy open, competitive and dynamic.

As we shall see below, however, changes in both the international and domestic political economies were soon to bring about a rethinking of tax policy.

The New Political Economy of Taxation in Sweden

Structural Changes in the Economy

In the 1970's the Swedish economy began a series of important structural changes. Ironically, some of these changes were the direct consequence of the public policies introduced in the previous decade. For example, pro-union policies dramatically increased union density in Sweden (Rothstein 1992). Many of these workers where not traditionally organized by LO unions (who generally represented classical workers) but were instead organized by either the TCO or by SACO unions. The significance of this change is that while Sweden - which had once been noted for its highly centralized wage negotiation system and unified and disciplined union structure - by the mid 1980s began to see conflicts between export oriented unions and those less subject to 'market discipline' (Notermans 2000: 24-26). It is far easier to find a common front between the interests of miners and auto workers, for example, than it is to find a common interest between medical doctors and day care employees. At the same time, the expansion of public employment dramatically increased the 'femininization' of the work force. As Diane Sainsbury points out, the increased participation of women in the workforce (mostly in public sector jobs) dramatically increased opportunity structures for women, but the political interests of women were not always coincident with men (Sainsbury 1996).

As Table 1 indicates, public employment in Sweden expanded very rapidly in the 1960-1980 period. Whereas public employment in Sweden was quite close to the OECD average in 1960, it was nearly double the average in 1980. Ironically, a consequence of many of these changes was the erosion of worker solidarity in Sweden. The growing diversity of interests (and the consequent splits in political demands on the part of workers generally) had direct consequences for both wage demands and public spending in Sweden. In the old Swedish Model, union wage demands could be tempered by the economic realities of the international marketplace, and decisions once reached at the elite level could be implemented at the local shop floor level due to the high degree of power of the central union organization (Swenson 1991). But by the late 1970's and early 80's the Swedish political economy was quite different. The SAF had abandoned the commitment to national wage deals, in part so that its members could pay higher paid workers more and hold down wages of lower paid workers (Moses 2000; Notermans 2000). Also, public employees (who have no international market discipline to temper their demands) were increasingly dominating the wage demand picture. Finally, the union organizations themselves were less able (and probably less willing) to hold wages back so that profits could be maintained (or public so that spending could be held in check). Given these basic facts, Sweden quickly developed strong inflationary proclivities. The government, desperately trying to maintain Swedish international competitiveness in light of these inflationary pressures, felt that it s only alternative was to periodically devalue the Swedish Kronor (Jonung 1999).

Table 1 goes about here Government Employment

Concomitant with the changes in the domestic political economy, the world economy was also undergoing changes that potentially had negative implications for traditional Swedish industries. Mining, steel, shipbuilding, autos were each stung by growing competition from especially lower wage Asian economies. It is of course extremely difficult to disaggregate the inflationary wage pressures specifically facing these industries in Sweden from the more general world wide trend in these industries to lower wage economies. Economists in Sweden came to believe that wage pressures in combination with the growing rigidity of the Swedish labor market resulting from the various Social Democratic policies introduced in the 1970's did not help (Calmfors and Göran 1980; Lindbeck 1997; Sverenius 1999:217-224)[12]. For example, it is also widely recognized that though the increasingly frequent (and sometimes quite dramatic) devaluations could temporarily improve Swedish industries international price competitive position, these policies did little to nothing to increase the long term competitiveness of the Swedish economy in anything like the way that the traditional Swedish model might have done.

Implication for Tax Policy

The political and structural changes discussed above had direct implications for the Swedish tax system. First, increasing demands for public programs and increasing wage demands from public employees directly led to the need for higher taxes. The result was that taxes eventually spiraled to over 60% of GDP by 1990.[13] Secondly, the combination of this tax pressure and the related inflationary tendencies in the Swedish economy meant that ever more Swedish citizens were being pushed up into personal income tax brackets which were originally intended to impact the very richest Swedish taxpayers.[14] In the short run, of course, the Treasury needed this bracket creep because it 'automatically' increased revenues.[15] In the longer run, these officials understood quite clearly that tax rates of this magnitude contributed directly to the inflationary cycle gripping Sweden in these years. In simple terms, workers (even, importantly, public sector workers) discounted the extra costs of taxes into their wage demands. As the noted Swedish economist Lars Calmfors noted in 1977: large groups of wage earners have moved up into the tax brackets where the progressiveness is so high that it is, in fact impossible to obtain increases in real disposable incomes through increases in nominal wages... Such a tax scheme could also decouple internal wage and external price trends. [16] The table below shows the consequence for the costs of Swedish labor.

Table 2 about here- Percentage change in Labor Costs 1970-1995

The Swedish economic elite both within the Ministry of Finance and in the economic profession more generally saw these developments as a crisis. Whereas in the past these elites believed they could manage their economy quite effectively, now they were increasingly convinced that such management was no longer possible. What were once thought of as labor market partners were becoming simply Interest Groups (Ruin 1981:149-151). In addition, whereas the political system in the earlier era insulated the fiscal elite and gave them enormous policy autonomy, now political demands on both the tax and spending side were increasingly difficult to shut out. In the words of one senior Ministry of Finance official, I was taught in college that we could manage the economy via fiscal manipulations. But now in Sweden, and other countries too, we have less faith in politicians. We now realize that political asymmetries are so large that you have to be careful about what you recommend. Politicians don t only do what their economic advisors recommend, they also have to listen to interest groups..... If economists think that political decisions are symmetric, then they use false assumptions. Politicians have short time horizons. [17]

Finally, the interests of capital itself began to change: The Swedish economy moved more towards services and towards production of more highly specialized and sophisticated production strategies, Swedish companies required more flexibility in terms of their investment strategies. The traditional Swedish tax regime dramatically tax advantaged domestic investment and openly discouraged foreign investment (but not, of course, foreign trade). By the 1970s Swedish capitalists were already complaining that this incentive system made it difficult for them to invest in lower end/skill technology abroad and this in turn made it difficult for them to focus their Swedish investment where Sweden had comparative advantage (ie. where highly specialized skills were needed.).

The sense of crisis was not necessarily shared by either politicians or average citizens in Sweden in the 1980s. To the extent that there were problems with the tax system, for example, it was generally believed that this was because it was not progressive enough (Hadenius 1984; Svallfors 1989). To the extent that there was a problem with Swedish democracy, public opinion polls demonstrate that citizens increasingly believed that political elites were not *responsive* *enough*. There has been a steep and steady increase in distrust of politicians and political leadership in Sweden since the late 1960s. (cf. Holmberg 2001: Table 9).

Tax Reform Swedish Style

Beginning in the late 1970's, Swedish economist as well as officials in the Ministry of Finance began to seriously question the long term viability of the tax system that was evolving. Again, there were several interrelated issues: Most importantly, 1) taxes were driving up wages and thus contributing to the inflationary pressures and thus economic imbalances. And 2) these elites came to believe that tax rates were being pushed so high that even ordinary taxpayers were engaging in a variety of non-productive behaviors and/or working in the underground economy simply for the purposes of evading taxes.(Agell, Berg, and Edin 1995; Muten 1988; Myrdal 1982). The Ministry had a substantial problem, however: The majority of Social Democrats in the Riksdag (Parliament) as well as the leadership of the LO did not agree that these were the central issues. Quite the contrary, they like most Swedish voters, believed that the problem with the Swedish tax system, quite bluntly, was that the rich and the corporations paid too little in taxes, while the lower and middle classes paid too much (Edlund 1999; Hadenius 1986; Svallfors 1989).

In a recent interview with Minister of Finance Kjell Olaf Feldt, he recalled it as follows:[18]

> .....One of the most important issues I began to work on in the early 70's was to change the Social Democrat s perspective on how we get a just income distribution in society. The negative inheritance I received from my predecessor Gunnar Sträng (Minister of Finance 1953? - 1976) was a strongly progressive tax system with high marginal taxes. This was supposed to bring about a just and equal society. But I eventually came to the opinion that it simply didn t work out that way. These taxes created instead a society of wranglers, cheaters, peculiar manipulations, false ambitions and new injustices. It took me at least a decade to get a part of the party to see this. That was a big deal, to change the outlook that had been built up since the 1940's. That I burned for.[19]

In pursuit of their ambitions to achieve tax reform, the Ministry of Finance began to commission a series of reports and analyses examining the effects of taxation on the economy, workers willingness to work, leisure time, tax wedges, capital formation, and a wide variety of other economic effects.[20] By the end of the decade the Socialists had passed a series of tax reforms which simplified the tax code, increased consumption taxes and scaled back a series of tax expenditures.[21] But it was not until 1991 (after they had been pushed out of office by the voters) that the government was able to pass Tax Reform of the Century. [22] With this reform, Sweden took a huge step from a tax system that relied on very high marginal rates and then softened these rates with very deep tax loopholes; to a much broader based tax system in which tax rates were reduced substantially for all taxpayers and tax expenditures were radically scaled back. Not only was the top tax rate on income reduced from over 80% to 50%,[23] but also, the tax system was simplified to the point where over 85% of tax payers no longer submitted a tax return at all. After this reform, the tax code possessed so few tax write-offs that the government would simply send a letter to the taxpayer showing the amount of income they had earned in the year and asked the taxpayer to confirm that they had no extra (not already taxed) income. Since there were so few tax exemptions left in the system, the taxpayer could simply sign the slip and send it back to the authorities... no further taxes would be due, and no tax refund would usually be issued. Corporate and capital taxation was also radically reformed. Now all capital income faced a flat 30% rate while deductions were substantially rolled back.[24] The Corporate Profits Tax was also reformed. The marginal tax rate was reduced from 57% to 30% at the same time that many of the most generous tax expenditures available in the code were now eliminated.

Figure 1 goes here Marginal Tax Rates 1989-1991

When the Swedish tax reform of 1991 was finally introduced by the bourgeois coalition government, many analysts saw this as the beginning of the end of the Swedish Welfare State. Though tax levels were quite high to be sure, gone was the public commitment to maintain a progressive tax system. Moreover, since the tax reform was underfinanced,[25] many analysts assumed that the lost revenues would eventually have to be made up with increases in taxes on lower income earners, or cuts in benefits for lower income earners, or both (cf. Steinmo, 1994). These predictions of course fit very well with the End of the Welfare State analyses which became so popular in the mid-1990's. Certainly Sweden, the most glaring example of a large and redistributive welfare state should have to fall considerably in the face of the global pressures for international policy convergence.

The tax reform also contributed to the massive economic crisis which struck Sweden in the early 1990's. It was once again the bourgeois coalition government's bad timing to come to office at the beginning of a recession (as they did in 1976), but there can be no gainsaying that the policies pursued by these governments (ie. with each party trying to pay off its particular constituency) substantially worsened Sweden economic situation. The tax reform, for example was underfinanced, in no small part to make it easier for the coalition to pass it. At the same time the tax reform dramatically increased a collapse in the real property market.[26] Unemployment increased to double digits whereas unemployment had never before gone over four percent in post-war history.

These factors then contributed to a massive increase in public *spending* despite the fact that the bourgeois government was at the helm. This government found itself incapable of cutting housing support, child payments, social welfare payments, sickness benefits or any other major social program in the context of an economic decline of this magnitude.[27] The result was that the budget deficit increased to 13% of GDP. At one point international confidence in the kronor sunk so low that the central bank was forced to increase the overnight lending rate to 500% in a vain effort to protect the currency. By 1992, then, it was widely predicted that both the Swedish Model and the Swedish economy were on their deathbeds.

Of course the most dire predictions did not come to fruition (at least not yet). The Social Democratic Party returned to office in 1994. Sweden s unofficial Party of Government quickly set about restabilizing Sweden s financial picture. At first it appeared that the Socialists had accepted the basic TINA logic as they began cutting back several social welfare policies. But careful analysis of these policies suggests that rather than slash programs wholesale, most of these reductions were in fact designed to make them a bit more fiscally reasonable and remove some of the opportunities for abuse that had been created earlier by the stunning generosity of these policies.[28]

But the new government did not appear to accept the idea that it must only cut welfare for the poor. Following earlier commitments,[29] the government initiated several studies which tried to examine the distributive consequences of the 1991 tax reform once the behavioral changes it created had been considered. These studies revealed that the Tax Reform of the Century was negatively redistributive. Armed with this evidence the Social Democratic government which returned to office in 1995 increased the top marginal rate of tax on very high income earners by 5% and also reduced the Value Added Tax on food by 50%. Since then the government has been trying to effectively hold the line and reestablish fiscal balance. The results of their efforts can be seen below (taxes, particularly on capital income, have increased rather than declined in the

1990's). Not only has financial balance been returned (indeed, just as in the United States after Clinton s increase in taxes on the very wealthy) but now Sweden appears to be benefitting from a substantial economic resurgence at the same time that it is generating quite substantial budget surpluses.

Table 3 goes about here -- Revenue Effects of Tax Changes in the 1900s

Continued Support for the Welfare State

Most non-Swedes find it surprising that Swedes did not revolt against their tax burden long before it reached 60% of GDP. Few Americans, in particular, can understand how and why a people could tolerate paying over half of their income to the tax authorities. But what we (non-Swedes) fail to understand is that most Swedes clearly believed they get a lot for the high taxes they pay. Survey after survey has shown that while Swedes (like virtually all citizens in modern welfare states) agree that taxes are too high, but only a minority of citizens support tax cuts if they are forced to choose them in exchange for reductions in public spending.[30]

Swedes appear to understand that taxes financed what many believed to be the world s most comprehensive welfare state. Not only is all health care, education, pensions, etc. financed virtually completely through public funds, as in most democratic countries. But by the mid 1980's, many social welfare benefits Sweden has become extraordinarily generous by any country s standards. [31] By the early 1990's t least 65% of Swedes receive a direct public subsidy from their government (Lindbeck 1997).

Certainly as a consequence of this basic fact, Sweden seemed to defy Down s prediction that Government would be too small in a democracy (Downs 1960). In fact, clear majorities of

Swedish citizens clearly believed that they got much for their tax dollar and as a consequence there was very little public pressure to cut taxes even though tax burdens were so high (Edlund 1999; Hadenius 1986; Svallfors 1989; Svallfors 1997a).

Table 4 goes about here Public Attitudes Towards Taxation and Spending

2000 and Beyond

Sweden s economic and fiscal picture has improved markedly in recent years. The first budget introduced in the 21st century predicted economic growth *and budget surpluses* extending for the next several years (see Table 5). Perhaps more importantly, it was heralded (and denounced by the right) as A Classic Social Democratic Budget (Gothenburg Post, 4-14-2000). To the surprise of many, the current budget surpluses have not been used to cut taxes on mobile capital as has been demanded by the right and by many business interests. Contrary to those who predicted that the end of the Redistributive State was at hand just a few years ago, the government has chosen to *increase* public spending on child support yet again and to continue using the surplus to paying off Sweden s public debt. Clearly, the Social Democrats are not behaving in ways that neatly fit the convergence hypothesis.

Table 5 goes about here The Government's Predictions

In sum, it appears that the Social Democrats have not given up their progressive ambitions. Contrary to many predictions on the Left (and to the clear disappointment of others) the SAP has decided *not* to use the budget surplus which it now benefits from in order to cut taxes on mobile capital. Instead, they have decided to use these revenues to add more aid to those at the bottom of the income scale. Almost certainly, future budget surpluses will be used to reduce taxes on particularly dynamic sectors of the economy, subsidize families, and continue to pay down the Swedish debt. With the Social Democrats coalition with the Left Party (and perhaps the Green Party as well) a virtual certainty into the next election it seems extremely unlikely that they will propose that the very wealthy should capture the lion s share of the economic upturn. Moreover, given the potent economic performance Sweden is now posting, combined with the daily discussions of the herds of new Internet millionaires in Swedish media, there appears to be little political incentive to cut these people s taxes. Instead, the current debate appears instead to focus on how to use the new wealth to spread Internet access (broadband) to even the furthest reaches of the Swedish hinterland.

Table 6 goes about here

Taxation in the New Political Economy

In the crisis period of the 1930's and 1940's it was quite common to here from both pundits and scholars that capitalism had come to a crossroads: Either economic change or political demands (or both) had brought about a transformation of capitalism as it had been known. Looking back, however, one could instead argue that it was the very policies developed in these decades that effectively saved capitalism. Instead of destroying capitalism, the very welfare state that many believed would undermine its key mechanism, had the opposite effects, by redistributing wealth and dampening the vicious swings of the free market, state policy effectively increased aggregate demand and reduced uncertainty. The results -- contra the predictions of the ideological right -- was that Sweden experienced a virtuous cycle of growth, productivity, and increasing prosperity.

But globalization, it was widely predicted, would put an end to the Swedish 'miracle.' Now that the exit option is far more readily available, surely capital and high end labor will exit not only Sweden but all high tax political economies (Tanzi, 1995:65-6; Schjelderup, 1993:377; Lee and McKenzie, 1989). The consequence, was to be a hollowing out of the welfare state and/or a massive retreat from the redistributive goals of (especially) Social Democratic nations.

The evidence presented here suggests that these predictions are wrong. The multiple changes we are seeing in the continued evolution of modern capitalism does impact tax policy makers, just as the continued evolution of the welfare state programs has enormous implications for policy makers in each of these specific arenas. These changes, however, do not spell the end of the welfare state any more than changes earlier in the century spelled the end of capitalism. This study reveals that a country like Sweden (again, one which was supposed to be *the most* vulnerable to these global competitive pressures) can prosper in a global economy and maintain its basic commitments to a relatively egalitarian community. (See Tables 6 and 7)

Table 7 Here -

In short, the multiple equilibriums observed in the later part of the 20th century have been upset. This does not suggest, however, that a new *single* equilibrium is imminent. Quite the contrary, institutional variation will once again structure how different nations respond to economic changes (cf. Steinmo 1993) and as a result new yet still multiple equilibrium should continue to be the most likely result.

Taxation and the Globalization Thesis Revisited

The keystone of the Globalization thesis is the argument that capital will leave countries with higher tax rates simply because they can get a better rate of return on their invested capital in countries with lower tax rates. This argument does indeed make intuitive sense: After all, even political economists can be smart enough to 'shop around' for CD's that offer higher rates of return. Surely as the transaction costs of international investment decline, so will investors propensity to 'shop around.' But as the example noted here is meant to illustrate, investments in CD's is not the same as investment in countries. There are a huge number of factors the influence the rate of return on investments in country x or country y which can be far more important to the investor than tax rates. It would be wrong to suggest that investors and potential employers are unconcerned with taxes, but survey evidence as well as over 50 interviews with corporate executives in the US and Europe conducted by this author all suggest that wage rates, quality of workforce, access to markets, quality of infrastructure, political stability and a host of other factors are generally *more important* factors used when deciding where to invest new capital (ie. whether to 'exit' or 'enter'). As several students who have examined location decisions within the US have discovered, there can be advantages to being near competitors, sources of highly educated labor, and suppliers which far outweigh the costs of being in cost areas (Devereaux and Griffith 1998; Hines 1993). Moreover, these factors can be positively affected by high taxes. Sweden currently appears to offer an example of some of the advantages of a high tax system: One in which the cost extracted by the state on employers, workers and consumers alike are indeed higher than in other competitive nations but one in which the advantages may still outweigh the costs.

Table 1
Government Employment, l87O-1994
(Percent of Total Employment)

	About 1870	1913	1937	1960	1980	1994
France	2.5	3.0	4.4	...	20.0	24.8
Germany	1.2	2.4	4.3	9.2	14.6	15.1
Japan	1.0	3.1	5.0	...	6.7	6.9
Sweden	*2.2*	*3.5*	*4.7*	*12.8*	*30.3*	*32.0*
United Kingdom	4.9	4.1	6.5	14.8	21.1	15.0
United States	2.9	3.7	6.8	14.7	15.4	14.5
OECD Average	**2.4**	**3.7**	**5.2**	**12.3**	**17.5**	**18.4**

Source: (Tanzi and Schuknecht 2000: Table 11.2)

TABLE 2
The Percentage Change in Labor Costs (Per hour- including Payroll Taxes) from previous year

1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
10.2	13.6	10.2	11.5	17	22.2	16.9	12.1	9.2	8.7	11.8	9.6	6.1
1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
9	10	7.7	7.8	7.8	8	11.2	9.1	8	2.4	-2.1	3.3	5

Source: (Lindbeck 1997: 92)

TABLE 3
Revenue Effects of Tax Changes in 1990s

Tax Changes in 1990's, Revenue Effects*

	1991	1992	1993	1994	1995	1996	1 997	1998
Earned income	-	1.5	7.3	6.3	6.4	-	-	-
Personal charges	-	-	3.8	4.2	9	4.7	4.7	4.7
Payroll charges	-	-1.3	-10.6	0.7	5.7	0.1.	-	-
Indirect taxes	-	-2	8.7	1.3	2.6	2.4	1.3	1.3
Corporate taxes	-	-0.2	0.1	0.5	0.2	-1	-1	-
Capital taxes	-3.4	-4.9	-3.7	-6.3	10.9	6	-	-
Total	-3.4	-4.9	5.6	6.7	34.8	12.2	5	6

*Approved and proposed tax changes 1991-1998 by initial year. SEK billion, current prices.
Source: Medium Term Survey, 1995, p. 402

TABLE 4

Public attitudes to taxation and spending in Sweden.

Responses to the Question: Taxes go to different purposes. Do you think that the taxes that go to the following items should be increased, decreased or held the same?

	Increase	Keep as is	Cut	Don t Know	Balance
Health and Sickness Benefits	47	45	3	4	44
Support for the elderly	37	55	3	4	33
Support for families with children	43	45	8	4	35
Housing support*	13	41	36	10	-23
Social Help**	17	51	22	10	-5
Research and Higher education	45	42	5	8	40
Primary and high school** education	32	61	2	5	30
Employment policies	56	29	10	5	46
State and Commune administration	2	32	55	11	-56

*Housing support (bostadsbidrag) is a direct support to people of lower incomes to help them pay their housing costs in private residences.
**Social Help (Socialbidrag) is a direct payment to low income individuals.
Source: (Svallfors 1989: 53)

TABLE 5
The Government s Predictions:
High Taxes and Economic Growth in Sweden 2000 and beyond

	1999	2000	2001	2002	2003
Change in GDP	37	37	30	20	20
State Revenue as % GDP	602	581	567	566	566
Public Spending as % of GDP	584	553	534	531	522

Source: Government Budget Proposition, PROP. 1999/2000:1000 Bilaga 1

TABLE 6
Taxes and Benefits, Redistributive Effects by Income Class, Sweden, 1997
(Mean values, thousands of kronor)

Income Group	Factor Income*	Taxed Benefits	Tax Free Benefits	Tax	Total Redistribution	Disposable Income
1-50	16.3	58.6	27.1	21.8	63.9	80.2
100-150	125.8	54.1	14.8	57.2	11.6	137.4
200-250	223.7	35	8.1	86.5	-43.5	180.3
300-350	273.7	35	9.4	122.6	-76	249
400-450	424.3	17.1	7.8	153.7	-128.9	295.4
500-550	522.5	19.9	7.2	199.6	-172.5	349.9
600+	995.6	18.2	7.8	393.1	-367.1	628.6

Source: (Riksskatteverket 1999: Table 7.7)
* Factor income includes: Income from wages, business, capital,

Table 7

Gini Coefficients and Redistribution, Selected Countries, 1995

	Before Taxes and Transfers	After taxes and Transfers	Percent Changes due to taxes and transfers
Sweden	48.7	23.0	-52.9
France	39.2	23.1	-41.0
Germany	43.6	28.2	-35.3
Japan	34.0	26.5	-22.0
United States	45.5	34.4	-24.5

Source: OECD, Economic Surveys, Sweden, 1999 Table, 13.

Figure 1
Marginal Tax Rates on Different Levels of Income, 1989-1991

Source: (Agell, Englund, and Södersten 1996: Figure 1)

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Endnotes:

1.This debate and these arguments have become quite common in the public literature and are thus sometimes discounted (Korten 1995). But various versions of these arguments have been offered and are taken very seriously also by some of the world's leading political scientists and economists as well. See for example: (Genschel, 1999; Lee & McKenzie, 1989; OECD, 1997; Pechman, 1987; Rodrik, 1997; Sandford, 1993; Tanzi, 1995)

2.See for example, (Garrett and Mitchell 1996; McKenzie 1989; Rodrik 1997; Swank 1998)

3.Public opinion polls indicate a continued commitment to specifically redistributive policies that has remained largely constant over the past two decades. (Svallfors 1997b). Even attitudes specifically focused on taxation have not changed appreciably in recent years. (Edlund 1999).

4.There is today a large debate over whether Sweden actually has had a successful economic performance of the past several decades. See note 13 below.

5.A Harvard report on tax policy in Sweden in the late fifties, for example, glowingly reported that this country had an arsenal of revenue devises unmatched elsewhere in the world (Norr, Duffy, and Sterner 1959). Assar Lindbeck, certainly the most influential and powerful economist in Sweden since Gunnar Myrdal wrote in 1970, for example, One can look in any elementary economics textbook today and see that we have the possibility through monetary and fiscal policy to maintain total demand in the economy exactly at any point that we wish (Lindbeck 1970: 20).

6.It was widely understood that companies had many more tax write-offs available to them than they generally took advantage of. However, due to their need to report at least some profits and pay some dividends to stockholders, corporations rarely took advantage of what was available to them. Knowing this, tax authorities almost never audited corporations, for they too understood that the companies were paying higher taxes than they had to. See Steinmo 1993: 120-126.

7.For small privately held firms and self employed individuals, the intersection of income tax rates over 80%, steep wealth taxes, and heavy mandatory social insurance charges meant that total taxes could exceed 100% of annual income.

8.This was called the Solidaristic Wage Policy in which LO unions would hold down wages in the most productive/profitable sectors (large firms, manufacturing, mining etc.) and push up relative wages in the less productive/profitable sectors (textiles, farming, small firms). The idea was to encourage structural modernization and change in the economy by literally increasing profits in some sectors while driving other companies and sectors out of business.

9.Most importantly, the Ghent unemployment insurance was established which effectively gave the unions control over unemployment insurance (cf. Rothstein 1992). But other pro-union public policies were also set up and certainly the anti-union incentives common throughout the capitalist world were eliminated.

10. Optimal fiscal policy was commonly taught in economic departments in Sweden and throughout the world.

11.In recent years there has been a very large debate among political economists and economists in Swedes over whether Sweden actually did so well in the post-war years. It is outside the scope of this paper to evaluate the conflicting claims made in these various econometric arguments. For our purposes two point are necessary. First, *at the time* (up to the mid-1970s at least) there was a broad consensus among political and economic elites that the Swedish economy had done remarkably well in the post-war years. Secondly, even the most critical analysts engaged in this current debate do not suggest that Sweden did poorly in the 1950s and 1960s, instead they argue that Sweden began to lag in the 1970s and 1980s. cf. (Dowrick 1996; Henrekson 1996; Korpi 1996).

12.(Moen and Wallerstein 1999: 259) argue that these arguments were probably overstated.

13.These taxes, moreover, were widely spread across the various revenue categories: The majority of income earners paid marginal income tax rates *over* 50%, social insurance charges (employers paid) reached over 35%; and the Value Added Tax was quite broadly distributed at a flat rate of 25% on most goods and services. The curious result was a tax system that produced enormous revenues, but was not in itself particularly progressive (Steinmo, 1993:2).

14.Moreover, these high tax rates had been used by finance officials in their micro management objectives. It was widely understood that in all but a few isolated cases (ie. tennis stars, and movie directors) the very rich very rarely paid these super high marginal rates. The tax expenditure system had been designed to allow the big capitalists to retain their wealth holdings as long as they left them in the corporate sector inside Sweden. By the mid 1980's, however, average industrial workers were paying marginal tax rates in excess of 50% of income.

15.Note that in countries with smaller spending needs such as the US, Japan and the UK, revenues generated from bracket creep could be distributed back to taxpayers and/or important interest groups (Howard 1997; Steinmo 1993; Witte 1983). In Sweden, however, the revenue needs of the state were so high that little could in fact be turned back, no matter how politically attractive this may have been.

16. Calmfors, 1977 #1423:531, quoted in Moses, 2000: 68

17.Interview with author, April 2000.

18.Feldt was Minister of Finance 1974-76 and 1980-1990.

19. (Sjöberg 1999). Actually the question was What does your heart burn for? (Vad brinner

din hjärte för?)

20.Some of the more important of these included were included in official public research reports (SOU). (SOU 1984; SOU 1987; SOU 1989a; SOU 1989b) There were, however, a great deal of other economic analyses conducted by economists in Sweden which also contributed to the reform agenda. Some of these include: (Agell 1986; Bertmar 1983; Hansson and Charles 1990; Jonung 1982; Lindbeck 1983; Lodin 1982; Södersten 1983)

21.See (Steinmo 1993: 187) for a list of some of the reforms introduced in the 1980s. Overall the tax system witnessed several hundred specific changes in this period.

22. Though actually introduced by a bourgeois coalition government in the 1991 Tax Reform represented the culmination of more than a decade s work on the part of the Social Democratic Minister of Finance, Kjell Olof Feldt.

23.Essentially, a two rate personal income tax system was created. All taxpayers paid flat rate local income tax rate (30% in most districts). Income over 74,824 Kronor (approx. $9,500) per year were also subject to the flat rate national income tax of 20%.

24.There were a large number of income tax base broadening measures, certainly the most important of these was to eliminate the deductibity of all interest payments from personal income tax. Before the reform, this write-off was so tax favorable that a large number of Swedes borrowed money for investment (particularly in real estate) and then deducted the interest. Given that almost all Swedes at that time had marginal income tax rates between 50 and 80 percent, this meant that the government effectively paid at least half of the cost of the investment. This cash machine resulted in a *net loss* in capital income tax revenue to the government (Agell, Berg, and Edin 1995).

25. Sweden was in the midst of the most serious recession in post-war history at the time. Thus it is difficult to specifically evaluate the exact costs of the tax reform. Subsequent analyses, however, suggest that the reform cost the Treasury approximately 3% of GDP (Agell, et. al. 1998).

26. By substantially eliminating the deductibility of interest even on owner occupied homes, those who had borrowed to finance purchases now found they could not afford their loans. Given that this occurred inside a general recession, the result was a collapse of the market.

27. GPD actually decreased in 1992, and 1993.

28. Thus, for example, employees were no longer eligible for full pay for up to three days sick leave even when they had no slip from a doctor. A number of similar reforms were reduced as well. Some, of course, cause considerable financial hardship in specific public bureaucracies. The health care sector appears to have been particularly hard hit (SOU, 2000: 145-158).

29. One of the commitments made to the LO during the final negotiations for the reform was that a analysis would be made of the reforms redistributive effects after the reform was introduced. This report would, then, be used to guide future tax-spending policy.

30. Taxes have traditionally been one of the many issues that voters felt were important, but in surveys taken since 1979 taxes have never been shown to be the most important issue deciding people s votes. Indeed taxes importance is generally dwarfed by specific issues like the environment , energy or (in 1982) the wage earner funds. I thank Sören Holmberg, for this insight.

31. For example, workers were given 18 months free from work when they had a child (this period could be divided between the man and the woman), workers could take up to 3 days off from

work for illness at full pay without going to the doctor, mothers received a substantial monthly payment for each child in their care. The list of public financed benefits could go on and on. See (SOU 2000)