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Review of The Making of Tax Law: The Development of the Swedish Tax System

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BOOK REVIEW

The Making of Tax Law: The Development of the Swedish Tax System

The Making of Tax Law:
The Development of the Swedish Tax System
by Sven-Olof Lodin
IBFD (2011)
228 pages
Price: US $75

Reviewed by Reuven S. Avi-Yonah, Irwin I. Cohn Professor of Law and director of the International Tax LLM program at the University of Michigan.

Imagine that a single person had been responsible for all U.S. tax reforms enacted from 1974 to 2012. That was the position of Sven-Olof Lodin, the former president of the International Fiscal Association. For more than 40 years, professor Lodin was the most influential voice in Swedish tax policy. This was not in a single, official governmental capacity, but rather as a member of more than 20 government commissions and working parties on taxation, which were responsible for all the major changes in Swedish tax law in recent decades, including the ''Tax Reform of the Century'' in 1991.

In this insightful and important book, Lodin describes in detail how the Swedish tax system evolved from 1948 to 2010. As a result, the reader gains a deep understanding of the Swedish political process and how it led to tax policy changes. Lodin also provides interesting descriptions of all the major political players.

The main development in Swedish taxation in the entire period was the rise of the ''dual tax system,'' under which capital income is subjected to much lower tax rates than labor income. In 1948 the corporate tax rate was 46 percent and the top individual tax rate on all income was 70 percent. In 2012 the top rate on wages was still a hefty 58 percent, but the corporate tax rate was only 26 percent and the rate on capital income 30 percent.

The reason for this change can be seen from Lodin's reaction to the 1948 tax reform:

> [T]he Wigforss tax reform [of 1948] transferred revenue from wages (lower income tax) to unearned income (higher corporate, wealth and inheritance tax) . . . Wigforss's statement displayed a poor understanding of the circumstances faced by entrepreneurs. A minister of finance would never speak that way in today's globalized world.[1]

Fundamentally, the switch to the dual tax system was motivated by the sense that since in a globalized world capital is more mobile than labor, it should be subject to tax at lower rates, lest it flee to other countries.

This view has implications for the United States as well. In fact, it can be argued that the U.S. already has a dual tax system because of the Bush tax cuts of 2001 and 2003, which resulted in a significantly lower tax rate on income from capital than on labor income. Indeed, distinguished tax scholars such as Edward Kleinbard have advocated an explicit move to a dual tax system.[2] Currently, there is a wide consensus that our 35 percent corporate tax rate, which is now the highest in the OECD, should be cut (to 28 percent, according to the Obama administration, or to 25 percent, according to Congressional Republicans) because of similar considerations.

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[1]Sven-Olof Lodin, *The Making of Tax Law: The Development of the Swedish Tax System* (IBFD, 2011), pp. 30-31.

[2]Edward Kleinbard, ''Reimagining Capital Income Taxation,'' NYU Colloquium on Tax Policy and Public Finance (2012).

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On the other hand, the Obama administration has also proposed the ''Buffett rule'' (named for billionaire investor Warren Buffett), under which millionaires would be subject to a minimum tax of 30 percent. This would require raising taxes on capital income (dividends and capital gains) to that level from the current 15 percent. Also, it has been suggested that any cut in the corporate tax rate requires raising the rates on dividends and capital gains to offset the revenue loss. But if capital is mobile, would the raise in tax rates on dividends and capital gains not lead to the same capital flight that the cut in the corporate tax rate was designed to prevent?

In my opinion, the most important lesson from Lodin's book is that the answer to this question is no. What is remarkable about the Swedish story from a U.S. perspective is how the country was able to maintain such high individual income tax rates. Currently, the tax rate on labor income is 58 percent and on capital income (dividends, interest, and capital gains) 30 percent. How can a small country like Sweden maintain rates that are almost double the current U.S. rates (35 percent on labor income and interest, 15 percent on dividends and capital gains), and collect a 25 percent VAT as well, without triggering capital flight and mass migration to other EU countries? After all, Swedes are free to move to other countries in the EU where tax rates can be significantly lower, and they can certainly shift their capital to tax havens.

The answer must be, as Tiebout predicted, that the Swedes are happy with what they receive in exchange for their high taxes: a cradle-to-grave welfare state.[3] If you believe you get what you pay for, you do not move to a country with lower rates and poorer services.

Thus, the relevant lesson for the U.S. is not that we should explicitly adopt a Swedish-style dual tax system. Rather, it is that we as Americans need to decide how much government we are willing to pay for. If we do not want to pay out of our own pocket for child care, college tuition, healthcare, pensions, or other expenses that in Sweden are provided for free by the state, then we should be willing to pay higher taxes. More practically, are we in fact willing to pay the price for the government programs we already have, such as Medicare, Medicaid, and Social Security, or do we want to drastically cut them? That is what this fall's election will be about.

Lodin's book may seem irrelevant to the burning issues of American politics. But the Swedish example carries important lessons. Sweden is not paradise, as any reader of Stieg Larsson's Millennium Trilogy knows. But it offers a fascinating contrast with our own predicament. ◆

[3]Charles Tiebout, ''A Pure Theory of Local Expenditures,'' 64 *J. Pol. Econ.* 416 (1956).

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