Abstract

Capital Mobility – The Swedish Structure of Taxes and Expenditures in an Integrated Europe

The purpose of this study is to describe the increase in capital mobility which has occurred during the last decade and to analyze the effects of the internationalization and deregulation of markets on the Swedish tax and expenditure structure. For this purpose, three types of capital are discussed: financial capital, direct investments or real capital investments, and finally, human capital.

The increased globalization of capital markets has been accompanied by large capital flows across borders. Transaction costs have decreased and deregulation of markets has paved the way for a greater degree of international diversification. The resulting capital flows make the costs of distortions in a country's tax and expenditure systems more visible and may also lead to increases in social costs from these systems unless distortive rules are changed. Furthermore, these capital flows make it more difficult for the government to raise revenues since tax bases are more mobile. In a similar way, generous benefit systems may encounter increased costs as more individuals make use of them as migration patterns are affected.

The study points to a policy dilemma. Resistance to adjusting tax and transfer rules to levels more compatible with other countries could lead to a loss of revenues and/or increase in expenditures. On the other hand, a reduction of tax rates will also tend to reduce revenues. In either case, limitations to taxation may bring about a reduced ability on the part of the government to redistribute income among its residents. It also underlines the need to carefully assess each expenditure item since required revenues are harder to raise.

The tax level on financial capital cannot deviate much from the tax levels in other countries because financial capital is the most mobile type of capital. In addition to the demands on capital taxation in a closed economy – with the desire to tax different types of capital

income in a similar way – an additional requirement is added in an open economy. It is important that financial capital invested in different countries be treated in a similar way for tax purposes. Here the study notes that Swedish savers face a relatively heavy tax burden on their savings. This may result in a low savings rate and it may also induce tax avoidance measures as well as the use of an institutional set up which minimizes the tax liability. Such constructions typically involve considerable efforts on part of the citizens as well as financial institutions and corporations and it is therefore associated with costs to the society.

Direct investments are not as sensitive to differences in taxes across countries. Other factors such as long-term market performance and strategic market decisions play an important role. The Swedish corporate tax structure is very competitive and generous rules for depreciation allowances etc exist. The corporate tax rate is 28 per cent which reduces the incentives to report large debts in Sweden since the value of deductions for interest payments is lower than in many other countries. The complexity of the tax system and frequent changes of the rules may however increase the uncertainty about how future returns eventually will be taxed and therefore reduce, in particular, long-term investments. It may be noted that the stock of Swedish foreign direct investment abroad exceed the stock of foreign direct investment in Sweden by a factor of almost 4. Instead, foreigners have typically undertaken portfolio investments in Sweden. The importance of sound macroeconomic policies and the availability of a well trained work force are other important factors when deciding where to undertake investments in real capital stocks.

The study concludes that high skilled labors have relatively low salaries in Sweden despite considerable hiring costs for businesses. High payroll taxes and high marginal income tax rates on even comparatively low incomes explain most of the difference. Both the tax system and the wage pattern may therefore contribute to increased migration of highly trained professionals. Furthermore, other taxes in addition to the tax on labor income, for instance wealth taxes and taxes on private dwellings play a role in migration decision and these taxes are high in Sweden compared with most other industrialized countries. On the other hand, transfers and benefits are largely extended even to high income earners which can be seen as a tax rebate. However, the need to consolidate public finances has tended to reduce these transfers at the same time as taxes have gone up. For middle aged workers and workers approaching their retirement age, the increase in tax rates may make it more difficult to accumulate enough private wealth to make it possible to opt out of the Swedish system (with pension rights etc). In these cases, the tax increases may actually reduce mobility while the opposite is true for younger workers.

In conclusion, the report points to the drastic increase in the flow of financial capital during the last decade and to the difficulties to deviate in taxation of financial instrument from that of other countries. The need for some adjustment appears to be largest on capital income for Swedish residents but also wealth taxes are high in an international comparison. These taxes increase the incentives for younger professionals to emigrate unless their after tax income compensate for the tax levies. Migration is likely to remain low but for certain groups it may increase. Also a relatively small number of specialists emigrating could however have an impact on the growth prospect of a country.