

NON-FISCAL OBJECTIVES IN THE NORWEGIAN TAX STRUCTURE

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1. INTRODUCTION

THE SUBJECT OF THIS REPORT IS THE NON-FISCAL PURPOSES OF THE NORWEGIAN TAX SYSTEM. SUCH NON-FISCAL BASIS FOR TAXES OR TAX BREAKS CAN BE FOUND WITHIN ALMOST ALL POLICY AREAS. FOR INSTANCE, THERE ARE SPECIFIC TAX RELIEVES OR TAX INCENTIVES AIMING AT HEALTH, CULTURAL, SOCIAL, BUSINESS DEVELOPMENT, FAMILY AND HOUSING ISSUES.

THE TWO LATEST INCOME TAX REFORMS IN NORWAY, IN 1992 AND 2006, BOTH IMPLIED AN EFFORT TO REDUCE THE NUMBER OF TASKS ATTACHED TO TAXATION, AND TO CONCENTRATE THE DESIGN OF THE TAX STRUCTURE ON A FEW AND IMPORTANT TASKS: TO *COLLECT REVENUES*, TO CONTRIBUTE TO *EFFICIENT RESOURCE ALLOCATION* AND TO *LEVEL OUT INEQUALITIES* IN INCOME. TAXES ALSO PLAY A ROLE IN *CONTROLLING BUSINESS CYCLES*, AND *CONTRIBUTE TO REGIONAL DEVELOPMENT*. HOWEVER, MANY TAX BREAKS UNRELATED TO THESE GOALS STILL EXIST. MORE ABOUT THIS WILL BE DISCUSSED IN SECTION 4.

IN THIS NATIONAL REPORT, I WILL FIRST ADDRESS THE TWO MOST IMPORTANT NON-FISCAL PURPOSES IN NORWEGIAN TAX POLICY: REDISTRIBUTION AND CORRECTING MARKET FAILURE. THEN I WILL GIVE A BRIEF OVERVIEW OF TAX EXPENDITURES THAT ARE ATTACHED TO OTHER PURPOSES. FINALLY, I WILL SUMMARIZE AND GIVE SOME COMMENTS ON POSSIBLE CONFLICTS BETWEEN THE DIFFERENT PURPOSES.

TAXES HAVE NON-FISCAL EFFECTS IRRESPECTIVE OF WHETHER THESE EFFECTS ARE INTENDED OR NOT. SUCH EFFECTS, FOR INSTANCE REDISTRIBUTIVE EFFECTS, WILL TO SOME EXTENT BE COMMENTED ON.

2. TAXATION AS DISTRIBUTIONAL POLICY

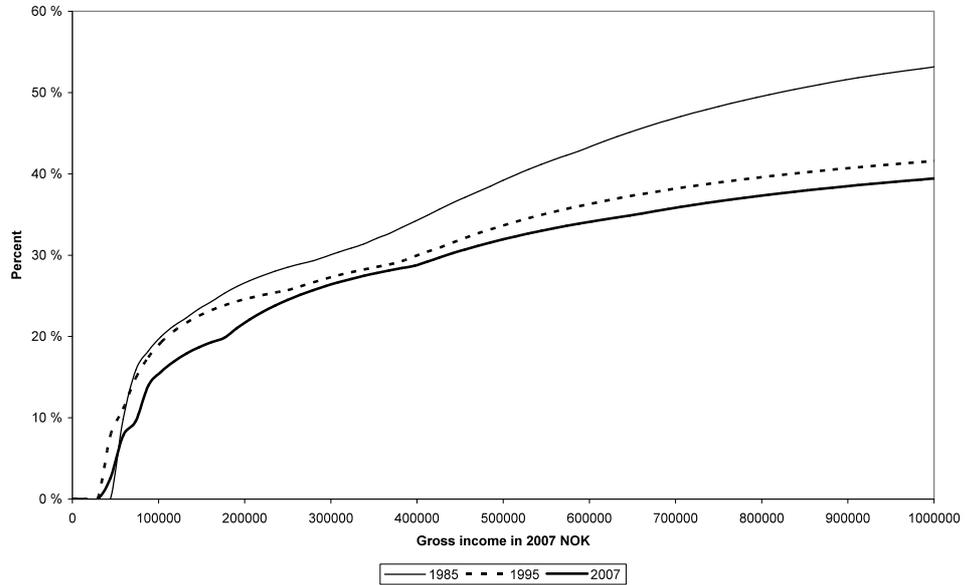
2.1 THE FORMAL TAX STRUCTURE

FIGURES 1 AND 2 SHOW STATUTORY AVERAGE AND MARGINAL TAX RATES² FOR AN UNMARRIED WORKER WITH ONLY WAGE INCOME AND STANDARD DEDUCTIONS IN 1985, 1995 AND 2007.

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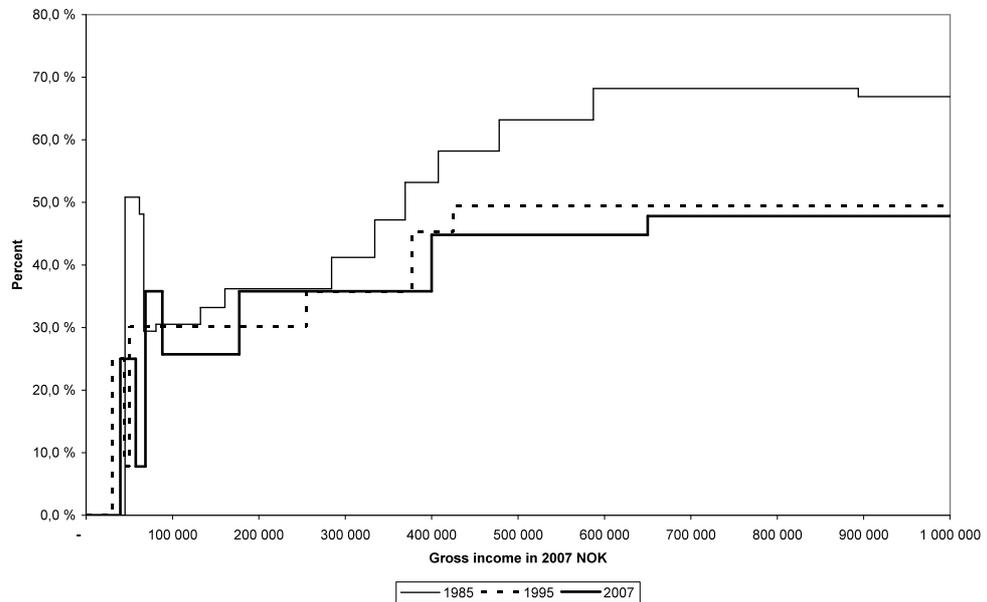
² PAYROLL TAX IS NOT INCLUDED, AS THE PAYROLL TAX DOES NOT AFFECT THE WORKER'S MARGINAL TAX.

FIGURE 1: AVERAGE TAX RATES IN 1985, 1995 AND 2007. INCOME LEVELS ARE DEFLATED WITH WAGE GROWTH RATES.



SOURCE: MINISTRY OF FINANCE

FIGURE 2: MARGINAL TAX RATES IN 1985, 1995 AND 2007. INCOME LEVELS ARE DEFLATED WITH WAGE GROWTH RATES.



SOURCE: MINISTRY OF FINANCE

AS SHOWN IN FIGURES 1 AND 2, STATUTORY DIRECT TAX RATES HAVE A PROGRESSIVE STRUCTURE, AND BOTH AVERAGE AND MARGINAL TAX RATES HAVE BEEN REDUCED IN THE PERIOD. THE HIGHEST MARGINAL TAX RATES ON LABOUR INCOME WERE 68.2 PCT. IN 1985, 49.5 PCT IN 1995 AND 47.8 PCT IN 2007. IT IS WORTH NOTICING THAT THESE FORMAL TAX SCHEDULES NOT NECESSARILY REFLECT THE ACTUAL TAX BURDEN. THE

DEVIATION BETWEEN THE FORMAL RATES AND ACTUAL TAX PAYMENTS IS ESPECIALLY LARGE IN CASES WHERE LARGE DEDUCTIONS CAN BE MADE OR THERE ARE OTHER POSSIBILITIES TO EVADE TAXES.

PRIOR TO THE 1992 TAX REFORM, THE POSSIBILITIES FOR TAX DEFERRALS AND DEDUCTIONS WERE EXTENSIVE. IMPORTANT DEDUCTIONS, LIKE THE DEDUCTION FOR DEBT INTEREST PAYMENTS, WERE SUBTRACTED FROM THE TAX BASE SUBJECT TO PROGRESSIVE TAX RATES. THIS SYSTEM REWARDED TAXPAYERS WITH HIGH INCOMES (AND HIGH MARGINAL TAX RATES) AND LARGE LOANS. OTHER EXEMPTIONS AND GENEROUS TAX RELIEVES CONNECTED TO A NUMBER OF DIFFERENT INTENTIONS, MADE IT PROFITABLE FOR HIGH INCOME HOUSEHOLDS TO ENGAGE IN TAX PLANNING ACTIVITIES. THIS UNDERMINED THE REDISTRIBUTIVE EFFECT OF THE HIGHLY PROGRESSIVE TAX STRUCTURE BEFORE 1992, WHICH IS ALSO CONFIRMED BY HANSEN, LANGBRAATEN AND THORESEN (1992).

NORWAY UNDERTOOK A MAJOR TAX REFORM IN 1992. LIKE MANY OTHER OECD COUNTRIES AND IN LINE WITH STANDARD ECONOMIC THEORY, TAX RATES WERE CUT AND TAX BASES WERE BROADENED, SINCE THESE MEASURES ARE ASSUMED TO REDUCE THE EFFICIENCY LOSS FROM TAXATION. ALSO, THERE WAS AN INSIGHT THAT THE HIGH FORMAL TAX RATES OF THE PREVIOUS YEARS HAD NOT CREATED THE DESIRED REDISTRIBUTION OF INCOME. SEVERAL OF THE SPECIFIC TAX RELIEVES AIMING AT DIFFERENT NON-FISCAL PURPOSES WERE ALSO CUT OR ABOLISHED. TWO DIFFERENT TAX BASES FOR PERSONAL TAXPAYERS WERE INTRODUCED: A GROSS INCOME TAX BASE (PERSONAL INCOME) SUBJECT TO SOCIAL SECURITY CONTRIBUTIONS AND SURTAX, AND A NET INCOME TAX BASE (ORDINARY INCOME), IN WHICH BASIC DEDUCTIONS, SPECIFIC DEDUCTIONS AND EXPENSES WOULD BE SUBTRACTED. ORDINARY INCOME WAS SUBJECT TO A FLAT TAX RATE OF 28 PER CENT.

THE 1992 REFORM INTRODUCED A DUAL INCOME TAX SYSTEM WHERE CAPITAL INCOME AND DIVIDENDS WERE TAXED AS ORDINARY INCOME AT A FLAT RATE OF 28 PER CENT, AND EARNINGS AND PENSIONS WERE SUBJECT TO TAXATION AS PERSONAL INCOME. SELF-EMPLOYED INDIVIDUALS AND OWNERS OF CLOSELY HELD CORPORATIONS WERE SUBJECT TO SPLITTING OF INCOMES INTO CAPITAL AND LABOUR INCOME TAX BASES, WITH A PROGRESSIVE SURTAX SCHEDULE IN WORK FOR LABOUR INCOME. HOWEVER, THIS SPLIT MODEL CONTAINED LOOPHOLES, WHICH WERE GRADUALLY ENLARGED IN THE YEARS TO FOLLOW.

AFTER THE 1992 REFORM, INCOME SHIFTING PROBLEMS STARTED TO OCCUR, SEE THORESEN AND ALSTADSÆTER (2008). AS A RESULT OF THE LARGE DIFFERENCE IN THE MARGINAL TAX RATES ON LABOUR AND CAPITAL INCOME, COMBINED WITH A LOOSE SPLIT MODEL, IT WAS BOTH POSSIBLE AND PROFITABLE TO DISGUISE INCOME FROM LABOUR AS CAPITAL INCOME. THE 1992 REFORM AND THE FOLLOWING INCOME SHIFTING PROBLEMS ARE ALSO DESCRIBED IN JACOBSEN (2008).

A NEW TAX REFORM WAS THEREFORE INTRODUCED IN THE PERIOD 2004-2006, IN ORDER TO REDUCE THE BIG DIFFERENCE BETWEEN MARGINAL TAX RATES ON LABOUR AND CAPITAL INCOME. THE REFORM IMPLIED IMPOSITION OF A DIVIDEND TAX OF 28 PER CENT ON DIVIDENDS EXCEEDING THE NORMAL RETURN, DEFINED AS A RISK-FREE MARKET INTEREST RATE. AT THE SAME TIME, THE HIGHEST MARGINAL TAX RATES FOR EARNED INCOME WERE CUT. THE MORE EQUAL TAX RATES ON EARNED INCOME AND CAPITAL INCOME WAS AN IMPORTANT FEATURE OF THE REFORM, IN THAT IT MAKES INCOME SHIFTING LESS PROFITABLE.

2.2 TAX PROGRESSIVITY

AMBITIONS TO REDISTRIBUTE INCOME BY IMPOSING HIGH FORMAL TAX RATES FOR HIGH-INCOME GROUPS MAY AS WE HAVE SEEN NOT ALWAYS BE EFFECTIVE. REAL EFFECTS OF TAXATION ON DISTRIBUTION MAY THEREFORE BE WORTH STUDYING.

IN THIS SECTION, I DISCUSS SOME RESULTS IN THE LITERATURE ON TAX PROGRESSIVITY IN NORWAY. BY TAX PROGRESSIVITY, I SHALL HERE REFER TO THE POST-TAX INCOME DISTRIBUTION BEING MORE EQUAL THAN THE PRE-TAX DISTRIBUTION OR TAX BURDENS BEING MORE UNEQUALLY DISTRIBUTED THAN PRE-TAX INCOMES. HOWEVER, ALTERED TAX LAWS ARE ONLY ONE OF SEVERAL FACTORS EXPLAINING CHANGES IN TAX PROGRESSIVITY. FOR INSTANCE, CHANGES IN PRE-TAX INCOME, DEMOGRAPHY, OR UNEMPLOYMENT MAY HAVE TAKEN PLACE. THIS WILL IN TURN AFFECT THE AMOUNT OF TAXES PAID BY DIFFERENT INCOME GROUPS. SEVERAL EMPIRICAL STUDIES HAVE BEEN DONE TO ANALYZE TAX PAYMENTS IN DIFFERENT PERIODS AND UNDER DIFFERENT TAX REGIMES, AND TO ISOLATE THE EFFECTS OF TAX REFORMS.

PRE-TAX INCOME INEQUALITY SEEMED TO INCREASE DURING THE 1990s. SINCE THE INEQUALITY IN TAXATION DID NOT INCREASE CORRESPONDINGLY, TAX PROGRESSIVITY, AS MEASURED IN TERMS OF COMPARING DISTRIBUTIONS OF PRE-TAX INCOME AND TAX BURDENS, DECREASED FROM 1991 TO 1999 (THORESEN, 2004). HOWEVER, FJÆRLI AND AABERGE (2000) POINT OUT THAT THIS INCREASE IN PRE-TAX INEQUALITY MAY HAVE BEEN DRIVEN BY CHANGES IN THE INCOME REPORTING BEHAVIOUR RATHER THAN ACTUAL CHANGES IN THE DISTRIBUTION OF INCOME. BASED ON THIS, THE EXPERT COMMITTEE ISSUING THE GREEN PAPER NOU 2003:9 SKATTEUTVALGET SEEMED TO SUGGEST THAT TAXATION CONTRIBUTED TO MODIFY THE INCREASING INEQUALITY OF INCOME AFTER THE 1992 TAX REFORM. IN SIMPLER TERMS, THE BROADENING OF THE TAX BASE IN 1992 MAY HAVE INCREASED THE REDISTRIBUTION THROUGH TAXES, AS A LARGER SHARE OF INCOMES BECAME TAXABLE. THIS MAY HAVE OUTWEIGHED THE EFFECT OF REDUCED STATUTORY TAX RATES.

ANOTHER FACTOR THAT COULD EXPLAIN AN INCREASE IN PRE-TAX INEQUALITY IS BEHAVIOURAL RESPONSES AS A RESULT OF THE REFORM.

REDUCED TAX RATES FOR HIGH-INCOME EARNERS COULD MOTIVATE THEM TO INCREASE WORK EFFORT, THEREBY INCREASING INCOMES IN THE UPPER PART OF THE INCOME DISTRIBUTION. HOWEVER, AARBU AND THORESEN (2001) FIND LITTLE EVIDENCE OF SUCH BEHAVIOURAL RESPONSES TO THE 1992 TAX REFORM; THE EFFECTS ARE RELATIVELY SMALL.

LAMBERT AND THORESEN (2008) FURTHER DISCUSS METHODS TO IDENTIFY CONTRIBUTIONS FROM TAX-LAW CHANGES FOR OBSERVED TAX PROGRESSIVITY PATTERNS OVER TIME, EXEMPLIFIED BY NORWAY 1992-2004. THEY POINT OUT THAT TAX PROGRESSIVITY IN NORWAY HAS DECREASED AFTER 2001. THE INCREASE IN PRE-TAX INCOME INEQUALITY, MAINLY EXPLAINED BY INCREASED DIVIDEND PAYMENTS, HAS GIVEN MORE UNEQUAL POST-INCOME DISTRIBUTIONS, RESULTING IN REDUCED TAX PROGRESSIVITY AFTER 2001.

THERE IS STILL NO EMPIRICAL EVIDENCE OF THE OVERALL DISTRIBUTIONAL EFFECTS OF THE 2006 TAX REFORM. THEORETICALLY, THE EFFECTS ON DISTRIBUTION COULD BE DRIVEN BY SEVERAL FORCES. TAX RATES FOR HIGH-INCOME EARNERS WERE REDUCED, IMPLYING REDUCED PROGRESSIVITY. THE POSSIBILITIES TO EVADE TAXES BY DISGUIISING INCOMES FROM LABOUR AS CAPITAL INCOME WERE TIGHTENED, THEREBY REDUCING "HORIZONTAL INEQUALITY". ALSO, A TAX ON DIVIDENDS AND GAINS WAS IMPOSED, SOMETHING THAT WOULD BE ABLE TO INCREASE PROGRESSIVITY. THE WEALTH TAX HAS BEEN LARGELY CHANGED DURING AND AFTER THE REFORM PERIOD, WITH THE AIM OF IMPROVING ITS REDISTRIBUTIVE EFFECTS. FINALLY, BASIC ALLOWANCES HAVE BEEN INCREASED, SOMETHING THAT WOULD ALSO INCREASE PROGRESSIVITY. THE REDISTRIBUTIONAL EFFECTS OF THE REFORM ARE THEREFORE AMBIGUOUS, AND TO WHAT EXTENT AND IN WHICH DIRECTION THE REFORM AFFECTED REDISTRIBUTION THROUGH DIRECT TAXATION, IS AN EMPIRICAL QUESTION.

THE IMPOSITION OF THE DIVIDEND TAX WAS ANNOUNCED IN ADVANCE, CAUSING SHAREHOLDERS TO WITHDRAW LARGE DIVIDENDS IN 2004 AND 2005. AS THE DIVIDEND TAX CAME INTO EFFECT IN 2006, DIVIDEND PAYMENTS SUDDENLY DROPPED FROM ABOUT 100 BILLION NOK IN 2005 TO ONLY ABOUT 7 BILLION NOK IN 2006. SUCH FLUCTUATIONS IN THE TAX BASES CAUSED BY BEHAVIOURAL ADJUSTMENTS RATHER THAN REAL INCOME CHANGES COMPLICATE POSSIBLE ANALYSIS OF DISTRIBUTIONAL EFFECTS.

IT MAY BE WORTH NOTICING THAT THERE NEED NOT ALWAYS BE A NEGATIVE TRADE-OFF BETWEEN EFFICIENCY AND EQUALITY. RØED AND STRØM (2002) POINT OUT THAT FOR INSTANCE IF LOW-WAGE WORKERS ON AVERAGE HAVE MORE ELASTIC LABOUR SUPPLY SCHEDULES THAN HIGH-WAGE WORKERS, PROGRESSIVE TAXES CONTRIBUTE TO A MORE EFFICIENT ALLOCATION OF THE TOTAL TAX BURDEN. AN IMPORTANT FEATURE OF "THE NORDIC MODEL" IS THE SIMULTANEOUS OCCURRENCE

OF SMALL WAGE DISPARITIES, GENEROUS WELFARE SCHEMES AND HIGH EFFICIENCY AND GROWTH.

AS WE HAVE SEEN, THE PROGRESSIVITY IN STATUTORY TAX RATES HAS BEEN LARGELY REDUCED SINCE 1985. THE SAME MAY HAVE HAPPENED TO EFFECTIVE TAX PROGRESSIVITY, BUT THE RESULTS HERE ARE AMBIGUOUS. BROADENING OF THE TAX BASE AND BEHAVIOURAL RESPONSES HAVE CREATED MEASUREMENT PROBLEMS THAT COMPLICATE THE ANALYSIS. NOU 2003:9 SKATTEUTVALGET SEEMED TO INDICATE THAT THE 1992 TAX REFORM DID CONTRIBUTE TO LEVELLING OUT INCREASING INCOME INEQUALITY, IN SPITE OF REDUCTIONS IN THE HIGHEST STATUTORY TAX RATES.

2.3 BENEFITS AND TAXATION

WELFARE SCHEMES IN NORWAY ARE OFTEN MEANS-TESTED, IN THE SENSE THAT THEY ARE CURTAILED IF A PERSON WORKS. IF A PERSON IS ENTITLED TO SOME KIND OF PUBLIC BENEFIT, THE *EFFECTIVE* MARGINAL TAX RATE³, IF THAT PERSON CHOOSES TO WORK, IS USUALLY MUCH LARGER THAN THE FORMAL TAX RATE.

AN EXAMPLE OF HOW COMBINATIONS OF BENEFITS AND TAX RULES CAN CREATE VERY HIGH EFFECTIVE MARGINAL TAX RATES IS THE CASE OF SINGLE PARENTS WITH SMALL CHILDREN, AND WHO ARE ENTITLED TO THE “TRANSITIONAL BENEFIT⁴”. THE TRANSITIONAL BENEFIT IS CUT BY 40 PERCENT OF EARNED INCOME ABOVE A FAIRLY LOW THRESHOLD. SINGLE PARENTS WITH MEDIUM OR LOW INCOME AND WEALTH WHO RECEIVE THE TRANSITIONAL BENEFIT ARE ALSO ENTITLED TO A TAX REDUCTION THROUGH A TAX LIMITATION RULE, WHICH IN TURN CAN CREATE VERY HIGH MARGINAL TAX RATES WITHIN SOME INCOME BRACKETS. IN ADDITION, THE EFFECTIVE MARGINAL TAXES CAN BE AFFECTED BY PAYMENT FOR CHILD CARE, CHILD CARE BENEFIT, CHILD CARE EXPENSE DEDUCTION, THE “CASH FOR CARE” BENEFIT, THE FAMILY ALLOWANCE SUPPLEMENT FOR SMALL CHILDREN AND THE ADVANCE PAYMENT OF CHILD MAINTENANCE, WHICH CAN ALL DEPEND ON THE SINGLE PARENT’S INCOME. IN THE EXAMPLE OF A SINGLE PARENT WITH ONE CHILD 2 YEARS OF AGE, AND WITH AN ASSUMED FULL-TIME ANNUAL WAGE INCOME OF ABOUT 350 000 NOK, GOING FROM NO WORK TO FULL-TIME WORK WOULD PAY ABOUT 78 000 NOK A YEAR. AT INCOME LEVELS WHERE BENEFITS ARE CUT ABRUPTLY, THE EFFECTIVE MARGINAL TAX RATE FOR SINGLE

³ THE EFFECTIVE MARGINAL TAX RATE CAN BE DEFINED AS THE CHANGE IN TAXES AND BENEFITS AS A RESULT OF A SMALL INCOME CHANGE, AS A FRACTION OF THE INCOME CHANGE.

⁴ THE TRANSITIONAL BENEFIT IS INTENDED TO SECURE INCOME FOR THOSE WHO LIVE ALONE WITH AND PROVIDE FOR CHILDREN. THERE ARE BOTH TIME-LIMITS AND LIMITATIONS ON THE AGE OF THE CHILDREN. ACTIVITY REQUIREMENTS (AT LEAST HALF-TIME WORK OR EDUCATION) ARE IMPOSED IF THE CHILDREN ARE AT LEAST 4 YEARS OF AGE.

PARENTS IS, THEORETICALLY, INFINITELY HIGH. ALSO OUTSIDE THESE POINTS, THE EFFECTIVE MARGINAL TAX RATE REACHES 74 PER CENT.

THE SINGLE PARENT EXAMPLE IS QUITE ILLUSTRATIVE FOR A NUMBER OF BENEFITS. NORDBERG (2007) EXAMINES TOTAL TAX RATES⁵ FOR ALL BENEFIT CLAIMANTS IN NORWAY. HE FINDS THAT BENEFIT RECEIVERS ON AVERAGE WOULD GAIN ABOUT 70 000 NOK IF WORKING FULL-TIME INSTEAD OF NOT WORKING AT ALL. THE TOTAL TAX RATE IS ABOUT 70 PERCENT WHEN COMPARING FULL-TIME WORK TO NO WORK. HE ALSO FINDS THAT ABOUT 4 PERCENT WILL BE ECONOMICALLY WORSE OFF IF WORKING FULL-TIME INSTEAD OF NOT WORKING AT ALL. THESE RESULTS ARE OF COURSE ONLY INTERESTING IF ONE ASSUMES THAT WORKING INSTEAD OF CLAIMING BENEFITS IS A REALISTIC OPTION FOR BENEFIT CLAIMANTS. THIS IS OBVIOUSLY ONLY PARTLY THE CASE. YET, AN IMPORTANT INSIGHT FROM THIS STUDY IS THAT THE OVERALL DISTORTIONS OF THE TAX STRUCTURE CANNOT BE PROPERLY ASSESSED WITHOUT TAKING THE BENEFIT SYSTEM INTO ACCOUNT.

2.4 OTHER TAXES AFFECTING DISTRIBUTION

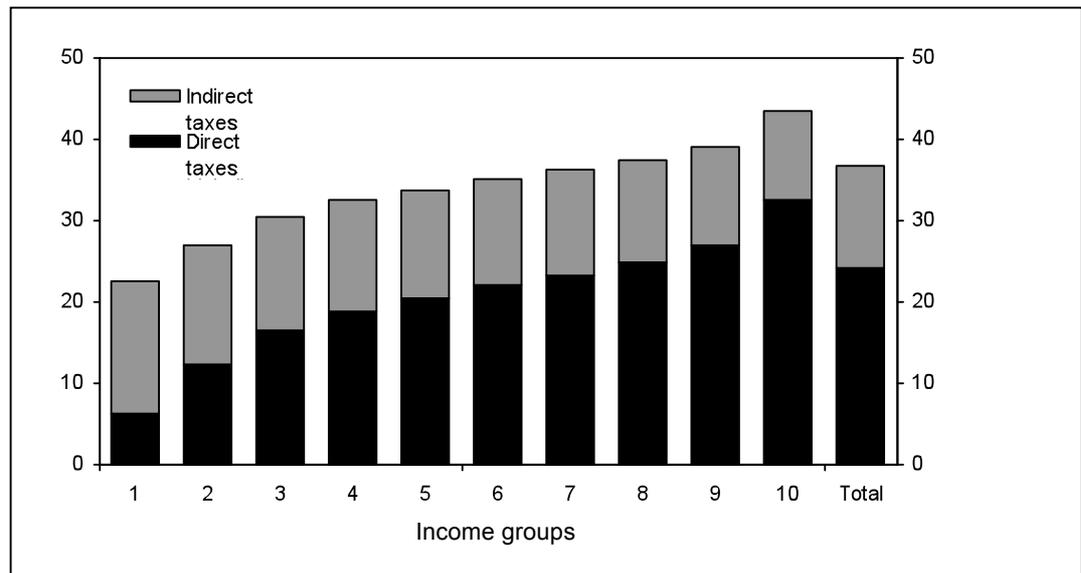
INDIRECT TAXES

INDIRECT TAXES ARE USUALLY NOT CONSIDERED TO BE AN INSTRUMENT IN DISTRIBUTIONAL POLICY. HOWEVER, THEY TOO HAVE REDISTRIBUTIVE EFFECTS. THESE EFFECTS ARE SUMMED UP IN THE BUDGET PROPOSAL EACH YEAR. FIGURE 3 SHOWS A TOTAL OF DIRECT AND INDIRECT TAXES AS A SHARE OF EQUIVALENT INCOME⁶ IN DIFFERENT INCOME GROUPS (DECILES) IN 2008, WHERE THE FIRST DECIL CONSISTS OF THE 10 PER CENT WITH THE LOWEST EQUIVALENT INCOME, AND THE 10TH DECIL CONSIST OF THE 10 PER CENT OF THE POPULATION WITH THE HIGHEST EQUIVALENT INCOME. FIGURE 3 SHOWS THAT INDIRECT TAXES HAVE A REGRESSIVE PROFILE, WHILE DIRECT TAXES HAVE A PROGRESSIVE PROFILE.

FIGURE 3: DIRECT AND INDIRECT TAXES PER PERSON AS A SHARE OF EQUIVALENT INCOME, 2008.

⁵ THIS IS DEFINED AS THE FRACTION OF THE EMPLOYERS WAGE COST NOT GAINING THE EMPLOYEE, AS FRACTION OF THE TOTAL WAGE COST.

⁶ EQUIVALENT INCOMES ARE COMPUTED IN ANALYSES OF PERSONAL INCOME DISTRIBUTION IN ORDER TO COMPARE HOUSEHOLD INCOMES WHEN HOUSEHOLDS HAVE DIFFERENT SIZE AND COMPOSITION, TAKING INTO ACCOUNT THAT THERE ARE CERTAIN ECONOMIES OF SCALE CONNECTED TO LIVING TOGETHER IN HOUSEHOLDS.



SOURCE: STATISTICS NORWAY AND THE MINISTRY OF FINANCE

SHIFTS FROM DIRECT TAXATION TOWARDS MORE INDIRECT TAXATION WILL THEREFORE USUALLY INCREASE INEQUALITY. THE INCREASE OF THE VAT BY OVER 6 BILLION NOK IN 2005, COMBINED WITH RELIEVES IN DIRECT TAXES, IS AN EXAMPLE OF A SHIFT OF THIS TYPE.

WEALTH TAX AND INHERITANCE TAX

WEALTH TAX AND INHERITANCE TAX ALSO AFFECT DISTRIBUTION. IN THIS PAPER, I WILL NOT GO FURTHER INTO THESE TAXES AND THEIR EFFECTS. HOWEVER, IT IS WORTH NOTICING THAT WEALTH TAXATION LATELY HAS BEEN CONSIDERED TO BE AN IMPORTANT INSTRUMENT IN DISTRIBUTIONAL POLICY, AS THE 2006 TAX REFORM SO FAR HAS SET RESTRICTIONS ON FURTHER INCREASES IN THE HIGHEST MARGINAL TAX RATES.

2.5 TAXES AND THE DISTRIBUTION ACROSS LIFE CYCLES

ONE COULD ARGUE THAT TAXES TO SOME EXTENT ONLY REDISTRIBUTE BETWEEN DIFFERENT STAGES IN PEOPLE'S LIFE CYCLES RATHER THAN BETWEEN INDIVIDUALS WITH DIFFERENT INCOMES. A PART OF TAXES PAID BY INDIVIDUALS IS GIVEN BACK AS PUBLIC BENEFITS TO THE SAME INDIVIDUALS IN OTHER STAGES OF LIFE. TAXATION IS THEREFORE A FORM OF COMPULSORY SAVING. ANALYSES CONCERNING INCOME OVER THE WHOLE LIFE CYCLE SHOW THAT PUBLIC BENEFITS TO A LARGE EXTENT IMPLY REDISTRIBUTION OVER LIFE CYCLES FOR THE SAME INDIVIDUALS. HOWEVER, THESE ANALYSES ALSO SHOW THAT THE DISTRIBUTION OF TAX PAYMENTS IS CONSIDERABLY MORE UNEQUAL THAN PUBLIC BENEFITS. THIS MAY INDICATE THAT TAXES ALSO CONTRIBUTE TO THE LEVELLING OUT OF INCOMES OVER LIFE CYCLES.

3. TAXES CORRECTING MARKET FAILURE

THE COMPETITIVE MARKET DOES NOT ALWAYS PRODUCE EFFICIENT OUTCOMES. THIS IS KNOWN AS MARKET FAILURES. THERE ARE SEVERAL WAYS A MARKET FAILURE CAN ARISE. OF PARTICULAR INTEREST FOR TAX POLICY ARE EXTERNALITIES. AN EXAMPLE MAY BE A FACTORY THAT IS POLLUTING AIR AND WATER IN SUCH A WAY THAT IT FOR INSTANCE REDUCES THE AMOUNT OF FISH IN THE WATERS FOR THE LOCAL FISHERMEN TO CATCH. THE POLLUTER DOES NOT TAKE ACCOUNT OF THE COSTS ITS POLLUTION HAS ON OTHERS, LIKE REDUCED INCOME FOR THE FISHERMEN IN THIS CASE. THE POLLUTION THEN HAS AN EXTERNAL COST THAT IS NOT TAKEN INTO CONSIDERATION BY THE FACTORY. THESE EXTERNAL COSTS ARE NOT INCLUDED IN MARKET PRICES. SEVERAL OF THE INDIRECT TAXES IN NORWAY ARE SUPPOSED TO CORRECT FOR EXTERNALITIES.

CO₂ EMISSIONS, AS WELL AS EMISSIONS OF OTHER CLIMATE GASES, CONTRIBUTE TO THE GREENHOUSE EFFECT. CO₂ EMISSIONS HAVE NO ENVIRONMENTAL CONSEQUENCES LOCALLY. MOREOVER, THERE IS A CLOSE RELATION BETWEEN THE CARBON CONTENT OF THE VARIOUS FOSSIL FUELS AND EMISSIONS OF CO₂. THESE PROPERTIES OF THE CLIMATE PROBLEM HAVE IMPORTANT IMPLICATIONS FOR THE FORMULATION OF A COST-EFFICIENT POLICY. GENERALLY, THIS POLICY CAN BE CHARACTERIZED BY THE FOLLOWING FEATURES:

- THE LEVEL OF CO₂ TAX SHOULD BE THE SAME FOR ALL FUELS, ONLY DEPENDING ON THE CARBON CONTENT.
- THE CO₂ TAX SHOULD BE THE SAME FOR ALL SECTORS OF THE ECONOMY.
- ALL GREENHOUSE GASES SHOULD BE SUBJECT TO THE SAME DEGREE OF POLICY RESTRICTION.

NONE OF THESE PROPOSITIONS OF AN OPTIMAL POLICY ARE MET IN THE EXISTING CO₂ TAX SYSTEM IN NORWAY. FOR INSTANCE, THERE IS NO CO₂ TAX ON COAL, NATURAL GAS AND LPG. IN ADDITION, THE CO₂ TAX ON PETROL IS MUCH HIGHER THAN THE CO₂ TAX ON MINERAL OIL. FISHING IS EXEMPTED FROM THE CO₂ TAX. THE NORWEGIAN CO₂ TAX IS THEREFORE NOT COST EFFICIENT.

SOME SECTORS ARE COVERED BY A PERMIT SYSTEM (EU-ETS) AND THEREFORE EXEMPT THE CO₂ TAX. IN A COST-EFFICIENT SYSTEM FOR PRICING OF CO₂-EMISSIONS, THE LEVEL OF THE CO₂ TAX SHOULD BE AT THE LEVEL OF THE PERMIT PRICE. HOWEVER, THIS WILL BE DIFFICULT TO ACHIEVE IN PRACTICE WHEN THE CO₂ TAX IS SET FOR ONE YEAR AT THE TIME WHILE THE PERMIT PRICE IS FLUCTUATING.

EXTERNAL COSTS ASSOCIATED WITH THE USE OF VEHICLES – ACCIDENTS, CONGESTIONS, NOISE, POLLUTION (EXCEPT CO₂) AND THE WEAR AND TEAR OF THE ROAD SURFACE - ARE PRICED BY THE AUTO DIESEL TAX AND THE PETROL TAX. THE INDIRECT TAX COMMISSION (SÆRAVGIFTSUTVALGET, NOU 2007: 8) CONCLUDED THAT THE PETROL TAX WAS AT APPROXIMATELY THE LEVEL OF ESTIMATES OF EXTERNAL

COSTS, BUT THAT THE DIESEL TAX WAS BELOW AVERAGE ESTIMATES OF EXTERNAL COSTS. THE COMMISSION THUS SUGGESTED AN INCREASE IN THE AUTO DIESEL TAX.

THERE ARE SEVERAL OTHER ENVIRONMENTAL TAXES IN NORWAY THAT ARE DESIGNED TO CORRECT FOR EXTERNALITIES. THEY INCLUDE THE SULPHUR TAX, TAX ON FINAL TREATMENT OF WASTE, TAX ON TRI AND PER, TAX ON HFC AND PFC AND THE TAX ON EMISSIONS OF NO_x.

IN ADDITION TO THE ENVIRONMENT RELATED TAXES, IT COULD ALSO BE ARGUED THAT TAXES ON ALCOHOL AND TOBACCO COULD CORRECT FOR EXTERNAL EFFECTS. THE USE OF ALCOHOL AND TOBACCO CREATES COSTS RELATED TO BOTH SOCIAL (VIOLENCE, DAMAGED CHILDHOOD, ETC.) AND HEALTH PROBLEMS THAT THE POLLUTER HAS NO ECONOMIC INCENTIVES TO TAKE INTO CONSIDERATION.

4. OTHER NON-FISCAL OBJECTIVES

EXEMPTIONS FROM THE GENERAL TAX RULES THAT REDUCE PUBLIC REVENUES ARE OFTEN DENOTED AS TAX EXPENDITURES. CORRESPONDINGLY, DEVIANT TAX RULES CAN ALSO IMPLY HIGHER TAXES FOR A GROUP OF PERSONS OR BUSINESSES THAN WHAT WOULD FOLLOW FROM A GENERAL OR UNIFORM TAX RULE. THIS IS OFTEN REFERRED TO AS TAX SANCTIONS. IN THE YEARLY BUDGET PROPOSAL, THE NORWEGIAN GOVERNMENT GIVES AN ACCOUNT OF SUCH TAX EXPENDITURES AND TAX SANCTIONS. TAX BREAKS THAT APPLY TO ALL TAX PAYERS, SUCH AS BASIC DEDUCTIONS, ARE NOT CONSIDERED TO BE TAX EXPENDITURES. TAXES ON ACTIVITIES THAT ARE CONSIDERED TO BE HARMFUL TO THE ENVIRONMENT ARE CONSIDERED TO BE TAX SANCTIONS ONLY TO THE EXTENT THAT THE TAX RATE IS HIGHER THAN WHAT WOULD BE REQUIRED TO OFFSET THE NEGATIVE EXTERNAL EFFECTS. THE REGIONALLY DIFFERENTIATED PAYROLL TAXES ARE CONSIDERED TO BE A TAX EXPENDITURE, ALTHOUGH REGIONAL POLICY PARTLY IS DEFINED AS A MAIN TARGET OF THE TAX STRUCTURE.

TAX EXPENDITURES CAN BE IMPOSED FOR A NUMBER OF POLITICAL REASONS, SUCH AS REGIONAL POLICY, BUSINESS DEVELOPMENT POLICY, HOUSING POLICY ETC. IN MANY OF THESE CASES, DIRECT SPENDING WOULD BE A FEASIBLE WAY OF ATTAINING THE GOALS THAT ARE SET.

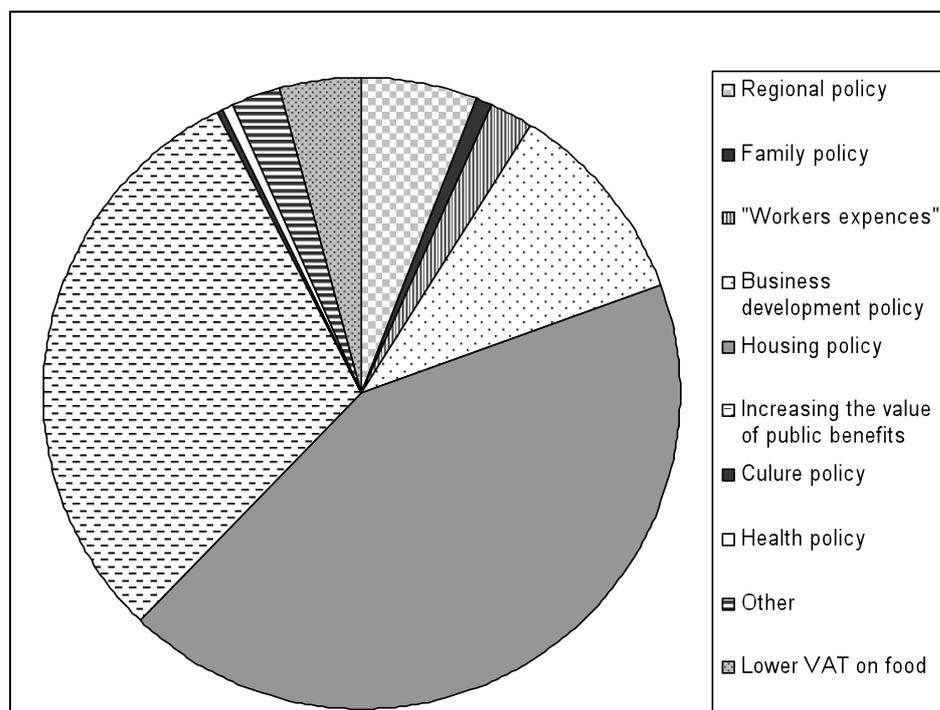
IN SOME CASES, THE MOTIVATION BEHIND TAX EXPENDITURES IS AMBIGUOUS OR UNCLEAR. THE LOWER VAT RATE ON FOOD SEEMED TO BE STATED AS A MEASURE OF IMPROVING LIVING CONDITIONS FOR FAMILIES WITH LOW INCOME. STILL, THE AVERAGE SHARE OF INCOMES SPENT ON FOOD IS ONLY ABOUT 10 PERCENT FOR NORWEGIAN HOUSEHOLDS. AS A REDISTRIBUTIVE MEASURE, REDUCING FOOD PRICES IS THEREFORE HIGHLY NON-ACCURATE. BESIDES, THERE IS LITTLE DOUBT THAT AN IMPORTANT MOTIVATION FOR THIS TAX CUT WAS TO RELIEF THE PRESSURE

TOWARDS NORWEGIAN AGRICULTURAL BUSINESS AS A RESULT OF I.A. CROSS-BORDER SHOPPING.

IN MANY CASES, THE MOTIVATION BEHIND A TAX BREAK AND THE EFFECTS OF THE TAX BREAK, DO NOT COINCIDE. THE HEALTH CARE EXPENSE DEDUCTION HAS A HEALTH POLICY OR SOCIAL POLICY MOTIVATION, GIVING TAX RELIEVES TO TAXPAYERS WITH UNUSUALLY LARGE EXPENSES DUE TO ILLNESS. ON THE OTHER HAND, THIS TYPE OF TAX RELIEF WILL HAVE A TENDENCY TO BENEFIT THE RICH RATHER THAN THE POOR, AS ONE WILL NOT BENEFIT FROM THE DEDUCTION SCHEME WITHOUT TAXABLE INCOME. ALSO, TAX AUTHORITIES WILL SELDOM BE THE EQUIPPED WITH THE RIGHT KNOWLEDGE TO MAKE DECISIONS ABOUT WHETHER EXPENSES HAVE OCCURRED DUE TO ILLNESS, OR WHETHER THE TREATMENTS THAT HAVE BEEN CARRIED OUT ARE ADEQUATE FOR THE RESPECTIVE ILLNESSES. IT HAS BEEN SUGGESTED, AMONG OTHERS BY NOU 2003: 9 SKATTEUTVALGET, THAT TAX RULES WILL NORMALLY NOT BE SUITABLE FOR SUPPORTING SMALL, SPECIFIC GROUPS LIKE THOSE WITH LARGE HEALTH EXPENSES.

THE BUDGET PROPOSAL FOR 2008 CONTAINS ESTIMATES OF TAX EXPENDITURES FOR 2007. IN THIS REPORT, 69 DIFFERENT TAX BREAKS OR TAX SANCTIONS ARE LISTED. NORMALLY, THE TAX EXPENDITURES ARE NOT ADDED UP. HOWEVER, TAX EXPENDITURES IN NORWAY AMOUNTED TO A TOTAL OF 177 billion NOK FOR 2007, OR 8 PCT. OF GDP. THIS NUMBER IS THE SUM OF ISOLATED ESTIMATES DONE FOR SOME (MOST) TAX EXPENDITURES. IN THESE ESTIMATES, BEHAVIOURAL RESPONSES AND INTERACTIONS BETWEEN THE DIFFERENT TAX EXPENDITURES ARE NOT TAKEN INTO ACCOUNT. THE SUM IS MERELY AN INDICATION OF THE IMPORTANCE OF TAX EXPENDITURES AS POLITICAL INSTRUMENTS, AND DOES NOT GIVE ANY GUIDANCE ABOUT THE POTENTIAL OF COLLECTING REVENUE BY ABOLISHING THE TAX EXPENDITURES. IN ESTIMATING THIS POTENTIAL, BEHAVIOURAL RESPONSES AND INTERACTIONS WOULD BE IMPORTANT. BESIDES, IF ONE SHOULD ABOLISH ALL THE TAX EXPENDITURES, IT WOULD PROBABLY BE CONSIDERED DESIRABLE TO CUT TAX RATES. IN ADDITION, THERE ARE TAX EXPENDITURES IN A NUMBER OF AREAS WHERE THE STATISTICAL AND ANALYTICAL BASIS FOR ESTIMATING THE SIZE OF THE EXPENDITURE IS NOT SUFFICIENT. THESE EXPENDITURES ARE THUS NOT INCLUDED IN THE GOVERNMENT'S ACCOUNTING, AND NOT IN THIS OVERVIEW. FIGURE 4 SHOWS HOW THE ESTIMATED TAX EXPENDITURES ARE DISTRIBUTED BETWEEN DIFFERENT PURPOSES (2007). THE LARGEST TAX EXPENDITURES ARE WITHIN THE AREAS OF HOUSING POLICY AND INCREASING THE VALUE OF PUBLIC BENEFITS. THE LATTER INCLUDES AMONG OTHER THINGS TAX ADVANTAGES FOR RETIREES.

FIGURE 4: ESTIMATED TAX EXPENDITURES BY PURPOSE, 2007.



SIMILAR ESTIMATES HAVE BEEN MADE SINCE 1999, IN THE FIRST YEARS ONLY FOR A FEW TAX BREAKS. WITHOUT RECALCULATING AND TRACKING BACK ALL THE TAX EXPENDITURES IN TODAY'S ACCOUNT OF EXPENDITURES, IT IS NOT POSSIBLE TO GIVE A PROPER PRESENTATION OF THE DEVELOPMENT OF TAX EXPENDITURES OVER TIME.

IN CONNECTION WITH THE 2006 TAX REFORM, EFFORTS WERE MADE TO REDUCE THE NUMBER OF GOALS ATTACHED TO TAXATION, AND ONE SHOULD THEREFORE EXPECT THE NUMBER OF TAX EXPENDITURES TO BE REDUCED. IT IS TRUE THAT THE REFORM TO SOME EXTENT SIMPLIFIED THE TAX CODE, AND A SET OF TAX EXPENDITURES WERE ABOLISHED, LIKE THE TAX EXEMPTION FOR TELECOMMUNICATION PAID BY EMPLOYERS, OR TIGHTENED, LIKE A TAX FAVOURABLE SCHEME FOR PURCHASING HOME-PCs BY WAY OF THE EMPLOYER. HOWEVER, THE ABOLISHMENT OF TAXATION OF IMPUTED RENT ON HOUSING BETWEEN 2002 AND 2005 WAS ESTIMATED TO DECREASE TAX REVENUES CONNECTED TO HOUSING POLICY BY ABOUT 2.5 BILLION NOK.

5. SUMMARY AND CONCLUSIONS

THE FISCAL PURPOSES OF TAXATION CAN BE IN CONFLICT WITH DESIRES FOR USING TAXES TO ACHIEVE NON-FISCAL GOALS. THIS IS DUE TO THE FACT THAT BUDGETS MUST BALANCE OVER TIME. FOR A GIVEN AMOUNT OF PUBLIC REVENUES, TAX BREAKS DIRECTED TOWARDS SPECIFIC GROUPS WILL IMPLY THAT TAX RATES FOR OTHER GROUPS MUST INCREASE, OR THAT PUBLIC SPENDING MUST DECREASE. THE LATTER WILL NORMALLY

AFFECT OTHER GROUPS THAN THE ONES WHO BENEFIT FROM THE TAX BREAK. IT IS THEREFORE NOT POSSIBLE TO USE TAX RULES TO ACHIEVE GOALS IN MANY DIFFERENT AREAS, WITHOUT REDUCING THE AMBITIONS FOR THE PUBLIC SECTOR, OR LETTING OTHER GROUPS PAY THE PRICE THROUGH INCREASED TAX RATES OR REDUCED PUBLIC BENEFITS. TAX REFORMS HAVE INTENDED TO REDUCE THE NUMBER OF DIFFERENT TASKS ATTACHED TO TAXATION, BUT THERE IS STILL A LONG WAY TO GO.

THERE MAY ALSO BE A CONFLICT BETWEEN EFFICIENCY AND THE DESIRE TO REDISTRIBUTE INCOME, AS HIGHER TAX RATES CREATE HIGHER EFFICIENCY LOSS FROM TAXATION. AS WE HAVE SEEN, TAX REFORMS HAVE ATTEMPTED TO BROADEN THE TAX BASE AND LOWER TAX RATES, IN ORDER TO REDUCE THIS EFFICIENCY LOSS.

ON THE OTHER HAND, IF LOW-WAGE TAXPAYERS RESPOND MORE STRONGLY TO CUTS IN TAX RATES THAN OTHER WORKERS, A PROGRESSIVE TAX SCHEDULE MIGHT BE IN LINE WITH EFFICIENCY DEMANDS. IN ADDITION, PROGRESSIVE TAX SCHEDULES WORK MORE EFFICIENTLY WHEN LOOPHOLES ARE TIGHTENED AND TAX BASES BROADENED. THIS WAS PROBABLY AN IMPORTANT EFFECT OF THE 1992 TAX REFORM.

THROUGH IMPROVING NEUTRALITY AND REDUCING INCOME-SHIFTING, THE 2006-REFORM AIMED TO IMPROVE EFFICIENCY. THE OVERALL EFFECTS OF THE REFORM ON DISTRIBUTION HAVE NOT YET BEEN ANALYZED EMPIRICALLY, AND THE THEORETICAL EFFECTS ON DISTRIBUTION ARE NOT CLEAR. ADJUSTMENTS TO THE REFORM IN ADVANCE AND IN THE FIRST YEARS OF THE REFORM, MAY COMPLICATE EMPIRICAL ANALYSES OF THESE EFFECTS.

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