



LUND  
UNIVERSITY

# Fiskal federalism och den nordiska nationalstaten

---

*ÅSA HANSSON LUND UNIVERSITY AND RATIO*



# To tax we need to determine:

- **Where to tax? What jurisdiction?**

- What location?
- Residence- or source principle (or citizen-based?)

- **What and who should be taxed?**

- Value added (income)
- What production factor produced the value added? Capital, labor, or land?

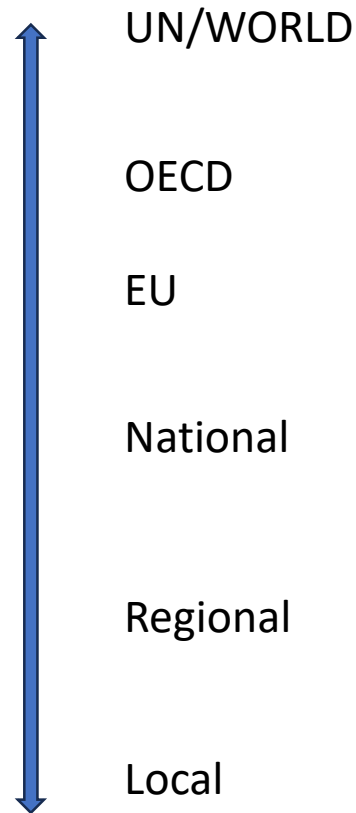
- **How much?**

- The size of the tax – need to measure the value added (income)

# At what level of government should a public good/service be provided and financed

- Does it matter at what level public goods and services are provided and financed?
  - YES!
- Vertical structure of the government matters, and the financing of public activities and the activities should be at the same level
- The Nordic countries are quite decentralized, in Sweden 70% of public welfare is local
- Is that sustainable?
- Trends
  - International fight over taxation rights, shift in taxation power upwards
  - New technology => link between location and activity weakens and increases labor mobility (higher elasticity of labor income)

# Vertical Structure of Government



- Taxation and spending at the same level
  - Defense?
  - Healthcare?
  - Redistribution?
  - Environmental policies?
  - Education?
  - Transport infrastructure?
  - Public parks?
  - Safety and order?

# Arguments for decentralization

- Tailor supply to local preferences – heterogeneous preferences are an argument to decentralize
- Introduce competition in the public sector - yardstick competition => efficiency
- Easier to innovate and experiment on a smaller scale
- Easier to hold policymakers accountable?
- Distributive arguments?



# Arguments for centralization

- Equity – large differences in tax bases and outlays across local regions
- Economics of scale – both on the spending and financing side
- Risk sharing – law of large numbers
- Externalities – what is efficient on a local scale may be inefficient nationally/globally
- Soft/hard budget constraints – if local governments have soft budget constraints the efficiency argument for decentralization weakens

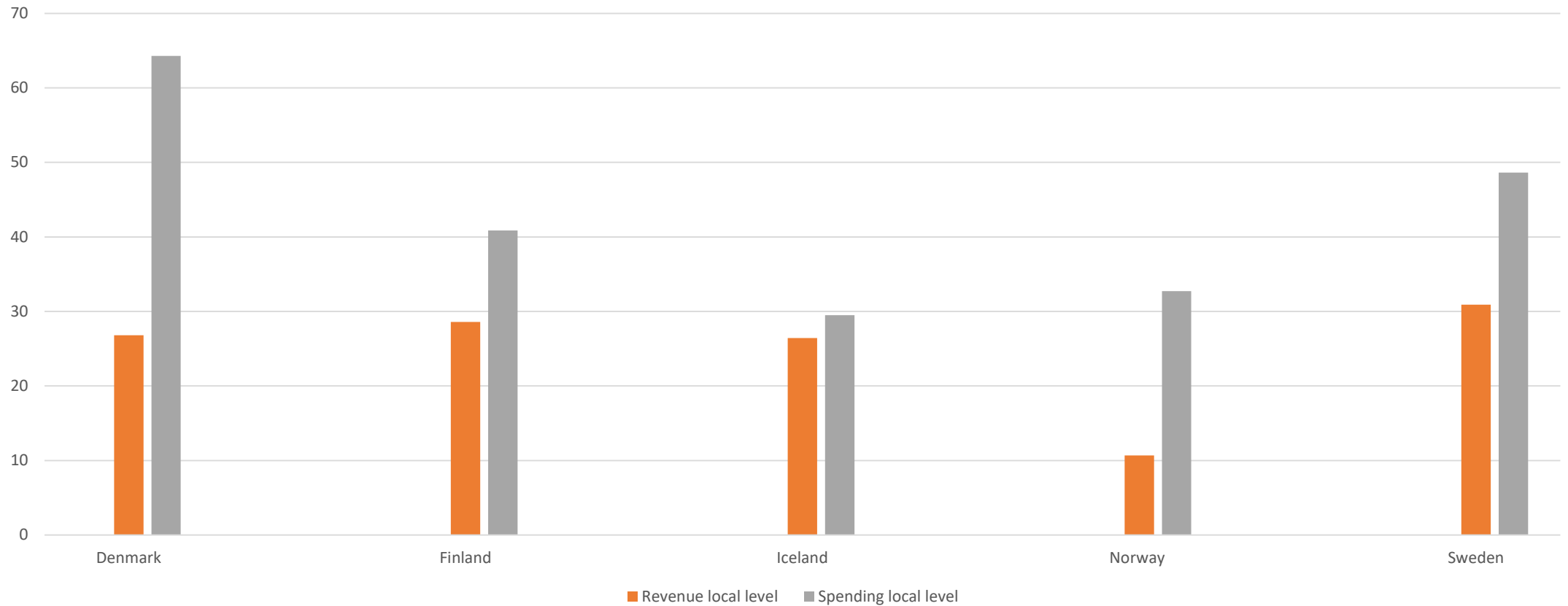


# How to balance the trade-off

- Decentralize if preferences are heterogenous and no spillover effects
- Centralize if preferences are homogeneous and large spillover effects
- Add political economy aspects: strengthen the arguments for decentralization
  - “The tragedy of the commons” with centralized financing and local utilities of the public activities

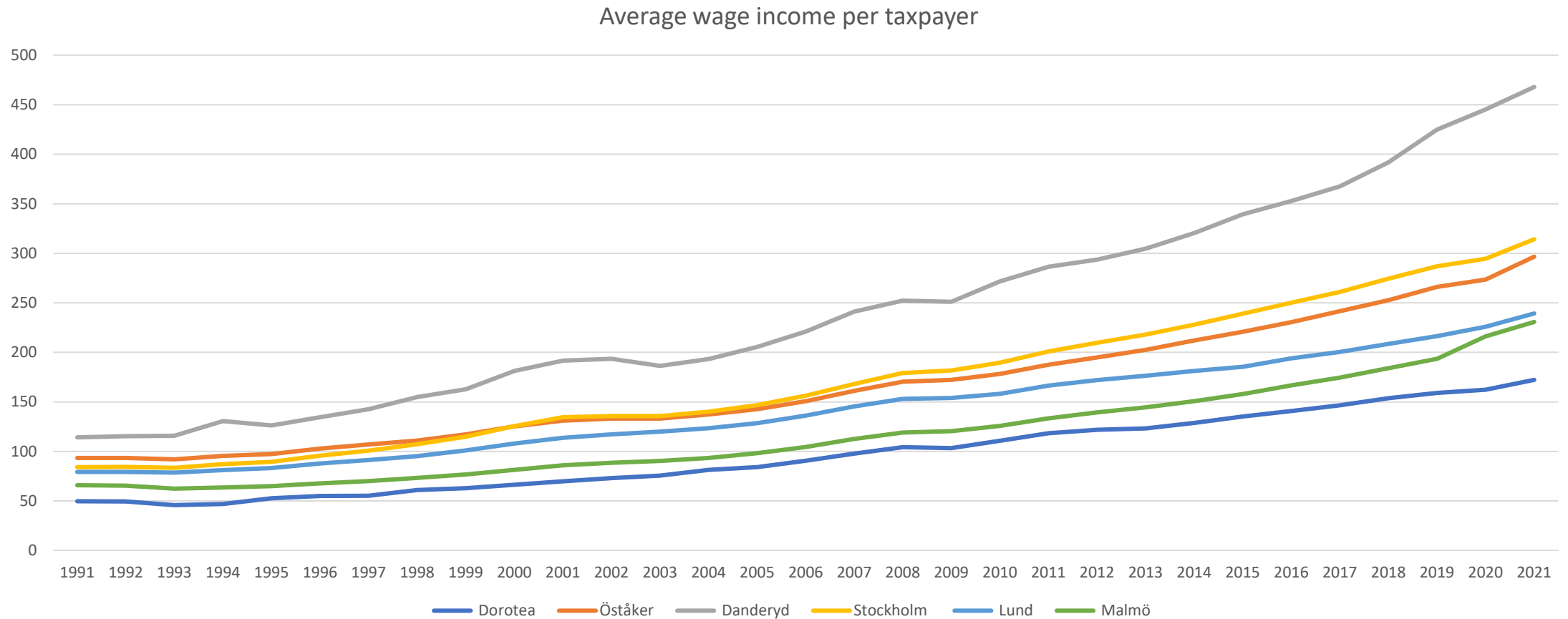


# Gap between local outlays and local tax revenue

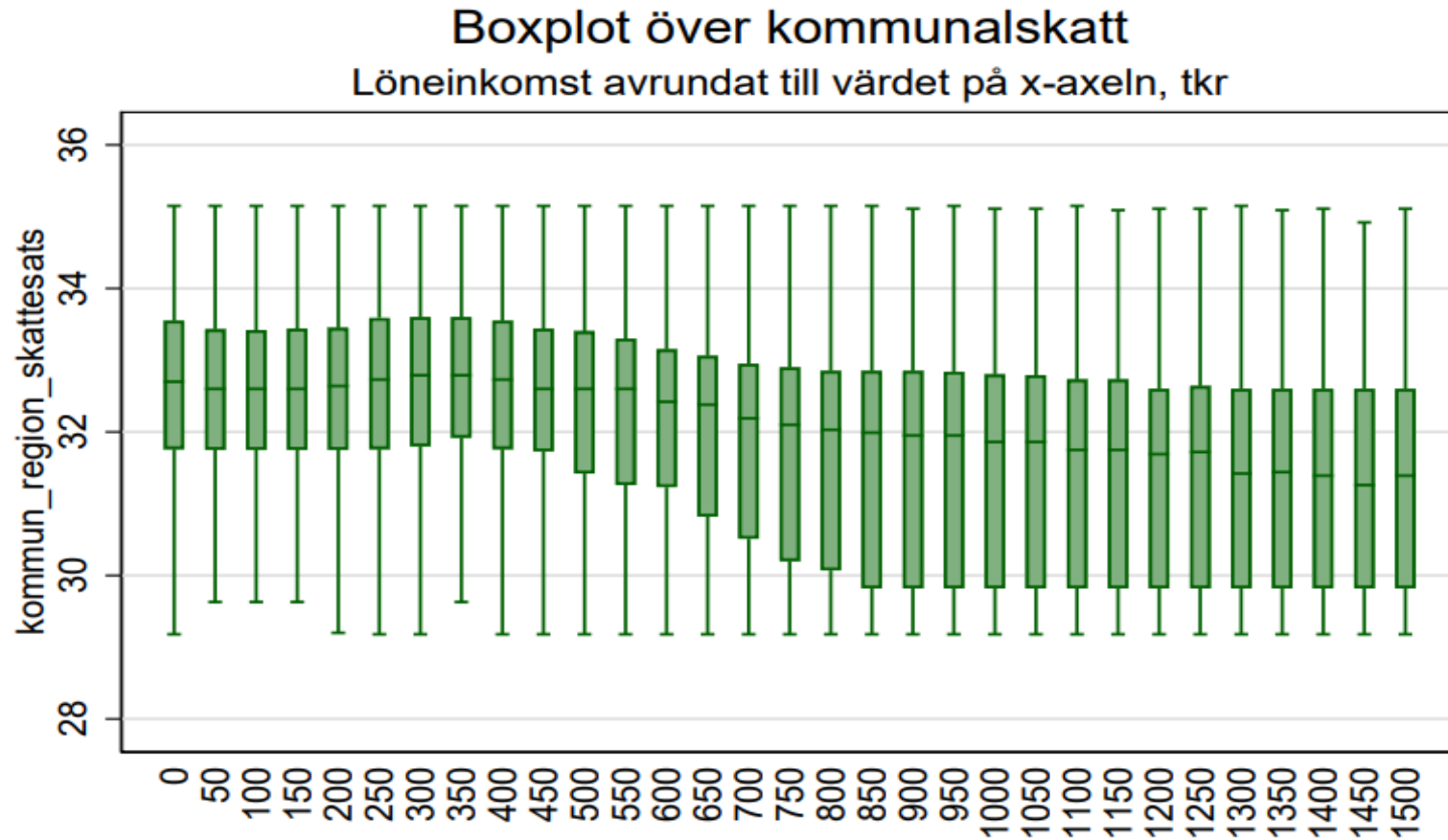




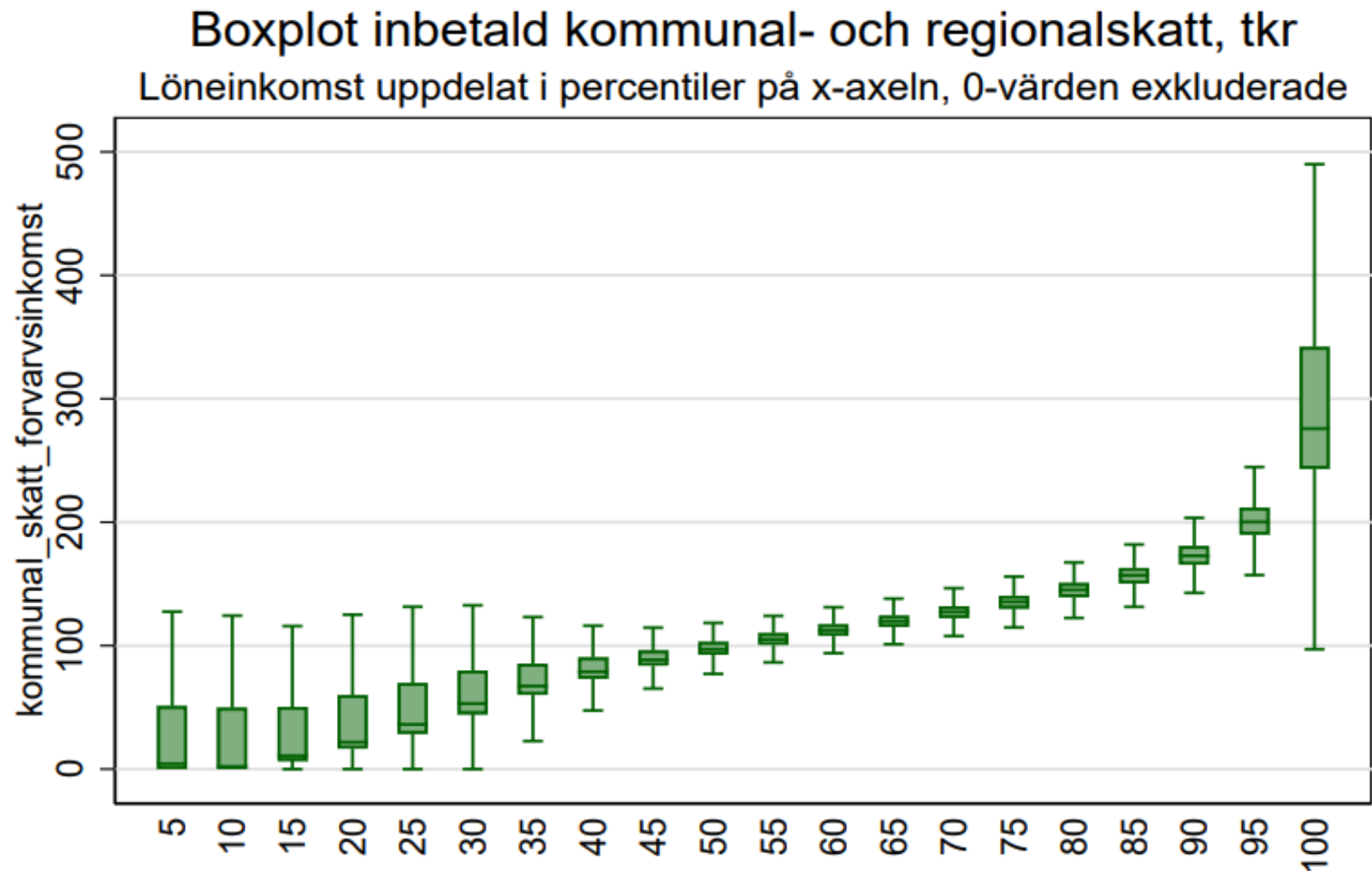
# Large and increasing differences in the local tax base across municipalities, Sweden



# Local tax rates over the income distribution - Sweden



# Differences in local tax payments over income distribution – horizontal equity?



# Need some kind of equalization mechanism

- Spending on the local level > tax revenue collected at the local level
- Large differences in taxation power across local jurisdictions
- Large differences in spending across local jurisdictions
- Equalize with intergovernmental grants
  - General and targeted

=> Inefficiencies and weakens the efficiency argument for decentralization

Taxing the same tax base at different levels => over-taxation

# Digitalization weakens the link between economic activity and geographical location

---

- The right to tax requires a physical presence
- Where is value created from consumption, corporate activity, and individual activity?
- Where should it be taxed?
- Harder to determine value creation
  - Value-chains change – what is the value and where is it created? Print something using a 3D printer? Spending time on FB, Amazon, Google what is the value, and where is it created?



# Is the current tax structure sustainable?

- Taxpayers are becoming increasingly mobile, and large differences in taxation depending on jurisdiction could => incentives to locate strategically
- 15% work from home more than 50% of the time in Sweden
- Shift in moving behavior among professionals, who move further away from their workplace
- Arguments to be employed weaken when “gigs” can be found => decreased labor tax base



# How to tax in a global and digitalized world

---

- Where to tax fly-in fly-outs or digital nomads?
- Countries now compete to attract taxpayers by offering favorable tax schemes for digital nomads
- Weakens the social/fiscal contact => can shop around and optimize over life-cycle
- More costly to tax labor income
- Empirical question whether this will be a real problem or not and challenge decentralized systems



# Corporate income has been mobile for some time

---

- For MNEs the link between economic activity and geography has weakened
- This has led to international tax coordination and cooperation (BEPS, Inclusive Framework with 145 countries)
  - Pillar 1
  - Pillar 2
- International fight over taxation rights and power shift in taxation
  - EU
  - OECD/G20
  - UN
- Shifting taxation rights towards market countries





# Corporate income has been mobile for some time

- But taxation is still a national competence (veto power) => compromise => complex and inefficient outcomes
- This has resulted in very complex rules with high administration costs
- Lack of transparency
- Democratic?
- Obtain the aim of “fairer taxation”?



# International agreements on labor taxation

---

- Now we may need international cooperation and coordination when it comes to labor taxation?
- International cooperation on labor taxation is absent and a much more important tax base
- 2017 OECD Model Tax Convention on Income and Capital



# Summarize

- Harder to tax labor income at local levels if labor becomes more mobile
- Already (without increased mobility) problems with decentralized governments
- Increased labor mobility will make it harder and more costly to tax labor locally
- International cooperation is unlikely to come up with efficient solutions

# What to do?

---

- Do we need to rethink and make dramatic changes to the tax system?
- Or can we mend and bend the current system?
- “International cooperation is still an attempt to square the circle – to force a century-old framework of taxation designed for a tangible economy into the reality of the data economy” (Marian 2022)
- Do we need to rethink what we tax (tax base) and where we tax (location)?



# What to do?

---

- Move away from taxing earned income at a local level, and instead tax more immobile tax bases such as natural resources and land, and even consumption?
- Do we need to shift up some activities and taxation rights to a higher level?
- Do we need to look at what can be taxed locally and adjust spending after the ability to tax instead of the other way



Thank you!