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Tax evasion and self-employment in a high-tax country: evidence from Sweden

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Acknowledgement

We thank Annika Persson for useful comments.

Notes

¹ There exist also other studies using different methods that also indicate that tax evasion is more prevalent among groups with more opportunity to evade. See e.g. Slemrod et al. ([2001](#)) and Joulfaian and Rider ([1998](#)). Blumenthal ([2001](#)) examine how normative appeals affect tax compliance using a randomized experiment.

² According to OECD data, the tax-to-GDP ratio in Sweden stood at 50.7% in 2004 which is the highest ratio among OECD countries; Denmark came second at 49.6%. Agell et al. ([1996](#)) provide an overview and evaluation of the major 1991 reform of the Swedish tax system.

³ The theoretical literature on tax evasion does not provide clear predictions regarding the relationships between tax rates and tax compliance. In the seminal contribution by Allingham and Sandmo ([1972](#)), an increase in the tax rate has an ambiguous effect on tax evasion: there is a substitution effect that works in the direction of increased

evasion. However, the literature also shows that the effect is ambiguous if agents' absolute risk aversion is high. In a survey of the literature, Alesina and Wacziarg (2007) show that the theoretical prediction is that the substitution effect dominates the income effect, and thus, the effect is ambiguous. However, the empirical evidence is mixed. For example, the survey by Alesina and Wacziarg (2007) shows that the substitution effect dominates the income effect in the case of the United States, but not in the case of the United Kingdom. In the case of the United States, the substitution effect dominates the income effect, and thus, the effect is ambiguous. However, the empirical evidence is mixed. For example, the survey by Alesina and Wacziarg (2007) shows that the substitution effect dominates the income effect in the case of the United States, but not in the case of the United Kingdom.

⁴ By effective tax rate, we mean the ratio of the tax paid to the tax base. Transfers are included in the tax base. The effective tax rate is defined as $\tau = T/Y^*$, where T is the tax paid and Y^* is the tax base. The average effective tax rate is defined as $\bar{\tau} = T/Y^*$. We have reported the average effective tax rate for the United States and the United Kingdom. The average effective tax rate for the United States is 28.5%, and for the United Kingdom it is 27.5%.

⁵ The data are from the Survey of Consumer Expenditures (SCE) from the U.S. Department of Commerce, Bureau of Economic Analysis. The data are from the Survey of Consumer Expenditures (SCE) from the U.S. Department of Commerce, Bureau of Economic Analysis.

⁶ We have used the data from the Survey of Consumer Expenditures (SCE) from the U.S. Department of Commerce, Bureau of Economic Analysis. The data are from the Survey of Consumer Expenditures (SCE) from the U.S. Department of Commerce, Bureau of Economic Analysis. The data are from the Survey of Consumer Expenditures (SCE) from the U.S. Department of Commerce, Bureau of Economic Analysis.



⁷ Disposable income thus includes transfers consisting of taxable transfers, such as sick pay and unemployment benefits, and tax-free transfers, such as child allowances and social assistance payments.

⁸ Pissarides and Weber ([1989](#)) define households as self-employed if income from self-employment accounts for at least 25% of total income.

⁹ The fraction of self-employed in total employment is 10% according to the labour force surveys of 2000. Note that our sample is restricted to couples. Moreover, our measure of the rate of self-employment in households is not directly compared to the labour force survey data based on individuals.

¹⁰ The food consumption ratios are substantially lower in 2003–2004 than in the previous surveys, a pattern also visible in the aggregate data published by Statistics Sweden. The likely main reason for the differences is that the measurement techniques have changed. According to Statistics Sweden ([2003](#)), the surveys for 1999–2001 produced an upward bias in food consumption by inducing households to include some nonfood items in their reports of food purchases.

¹¹ Age is the age of the ‘household head’, which is the person with the highest income in the household; type of housing is a dummy for single family housing; regions are so called H

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¹⁶ We have examined whether the basic results are affected by relaxing our maintained assumption that the Engel curves for employees and self-employed have the same slopes. There is some evidence from the OLS estimations that the Engel curve for employees is slightly steeper, but this has negligible effects on the estimated degree of underreporting for the main part of the income distribution. The IV estimates do not indicate any differences in slopes.

¹⁷ Skatteverket ([2006](#)) presents evidence based on tax audits that implies underreporting of a similar magnitude for this group of self-employed.

¹⁸ According to data from Statistics Sweden, the amount of reported entrepreneurial income (inkomst av näringsverksamhet) accounts for about 3% of total reported labour income as defined above. The amount of hidden entrepreneurial income relative to total reported income is thus given as

¹⁹ Persson ([2005](#)) compares earnings among employees and self-employed using Swedish data for 2002 and find substantially lower reported earnings among the self-employed even after having standardized for industry affiliation. The paper does not distinguish between incorporated and unincorporated businesses, however.

²⁰ See Hamilton ([2000](#)) for a study of the returns to self-employment in the United States. Hamilton finds that the returns to self-employment are significantly higher than those to employment.

employment benefits that job

²¹ According to the survey, the average person worked on

²² We include industry fixed effects to control for persistent industry effects but also control for individual fixed effects. However, the regression coefficients on the industry fixed effects are not significant. The estimated degree of underreporting of income.

²³ The evidence implies .

²⁴ One example is the paper by Bovi ([2003](#)), where the determinants of underground (OECD) economies are examined. Bovi finds that the underground economy is mainly affected by variables capturing 'institutional failures' and to a lesser degree taxation and market regulations.

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