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Local taxation in the interwar years: Sweden in Europe

Introduction

The topic of local finance has been a major political issue over the last twenty years. Beginning with tax revolts and a crisis of local finance in large parts of Europe and the US in the 70s, the issue reached its peak with the spectacular defeat of Margaret Thatcher on the question of local taxes in 1990.¹ In Sweden, the early years of the 1990s saw an extensive debate on the issue of local finance. That debate evolved on a new form of block grant from the central state to the municipalities. Following a committee proposal, the central government introduced a grant calculated so that the larger cities in Sweden lost resources in comparison to the earlier grant system. A collision between the central state and the big cities is, of course, not a particular Swedish phenomenon. Rather, that question has pervaded the debate on local government through the 70s and 80s in Western Europe and USA.²

This article will investigate local taxation in Sweden during the interwar period when local finances also consistently entered the political agendas of the European countries. After a brief outline of the development in Sweden, it will connect the issue to the political and economical theorising on tax policy, and attempt a preliminary comparison with other countries. The article will argue that the existence of strong worker and farmer parties can explain why the political battle over local taxation seemed to be more severe in Sweden than in other countries. Furthermore, the article will maintain that the difficulty in overcoming the clashes also had the outcome of giving the country a local tax system that, from a normative economical perspective, had major flaws.

Theories on local government and local taxation

Institutions of local governments have a long history in Europe.³ However, with the French Revolution the concept of “communes” gained status in the political world of Europe. The revolutionaries derived the “commune” from the theory of natural rights and saw it as a counterweight to the repressive central state. Local government continued to exist in Europe after the revolution, although for more prosaic reasons than natural rights.⁴ In the liberal state of the 19th century, local government became a preferred entity for producing public ben-

efits for its citizens. The municipalities grew in importance, and so did the costs for providing municipal services. In the liberal notion of society, the justice of taxation ranked high.⁵ Due to the increasing burden on the citizens for municipal activity, the issue of local taxation grew more important politically.

Public administration was and is divided into two tiers, the central and the local. The position of local government within the central state differs between federal and unitary states. In the federal state, the tasks entrusted to local government, as well as the financial means to pay for those tasks, are set constitutionally. Thereafter, the two tiers are supposed to fulfill their tasks independently. On the other hand, in the unitary state, the agency theory maintains that local government is an administrative body of the central state. Those two theoretical constructions are ideal types and, in reality, different states oscillate between the extremes.⁶ Sweden, however, is historically a unitary state within which federalist thoughts have been treated with disdain. Nevertheless, quasi-federalist concepts often pervaded the debate on local government and local finance during the interwar years, in both scientific and political discourse.

Looking at the federal theory of local government, fiscal federalism normatively meets the question of what the two tiers should do and how they should finance their tasks. Both the central state and the municipalities produce public goods. However, public goods can be either beneficial or redistributive. Street-lighting, for example, is a beneficial public good which cannot be produced by the market for individual consumption, since it is impossible to exclude anyone from consuming it. The free-rider problem arises from that property of a public good. Furthermore, street-lighting cannot be divided into individual units of consumption, which means that it cannot be charged. Social care, on the other hand, is a redistributive public good, which involves a transfer from people with resources to people in need.⁷

Historically, care of the poor as well as street-lighting have been local tasks. Within local government theory, however, redistributive goods should be preferably financed by the central state and the beneficial public goods preferably locally. Consequently, the taxes financing public production of services should theoretically follow two different principles. Taxes for redistributive, or onerous, which was the concept used in 19th century, goods are raised according to the ability-to-pay-principle with the effect that the wealthy have to pay more than the less wealthy. By contrast, the beneficial public goods should be financed by taxation according to the principle of benefit with which objects are taxed according to the benefit they receive out of public goods production.⁸

The institutionalization of local government

The federal approach describes the logical setting of the relations between central and local governments, but in all European countries the system of local government emerged historically without such logical structure. Schools and

care of the poor were at least to some degree traditionally financed locally, although they were of a redistributive character. There were differences in local taxation among the countries in 19th century Europe. Great Britain used only property taxes, “rates”, but the Scandinavian countries, for example, allowed the municipalities to levy an income tax. From John Stuart Mill onwards, quasi-federalist conceptualisation emerged over the years as the taxes soared.⁹ In 1893 Prussia introduced a reform where parts of the local taxes were levied according to the benefit principle of taxation and parts after the ability-to-pay principle. On the other hand, the latter principle dominated the direct taxation of the central state. The tax system should mirror the fact that municipalities predominantly provided goods that did not count as onerous.¹⁰ In addition to taxes and other local incomes, the municipalities were recipients of grants from the central state, not least for the costly public education. In the later decades of the 19th century not only in Prussia, but also in for example Great Britain and the Netherlands, the central state tried to provide a stable situation on the field of grants.¹¹ Those efforts did not succeed and after the First World War reforms of grant systems often occurred.

The reliance of local governments on grants differed widely between countries in the interwar period. Germany and Austria were examples of countries being revolutionised in 1918. In such countries, the system of local government financing could be re-established without the severe constraints historical structures imposed upon countries not being so thoroughly changed.¹²

The relation of central grants to total local government income for the year of 1929 had developed as follows:

Table 1: Central grants in relation to total local income

Country	Grants
Austria	77.5%
Germany	70.0%
Belgium	65.0%
France	56.0%
Holland	33.0%
England	31.0%
Sweden	15.1%

Source: Schalling 1929:489–490.

In the Weimar-republic, which was a federal state, local income taxes were levied at the state level, and thereafter distributed to the municipalities. France and Belgium were not revolutionised after the war, but they had historically relied upon central administration and financing.¹³ Given a non-revolutionary societal development, Sweden, together with the Netherlands and England, formed a group because they tended to rely not only on local administration but also on local revenue. In those three countries, politicians debated the issue of local taxation heavily. The reasons for why local taxation evolved as such a central political problem will be the discussed in the next section.

The politicisation of local taxation

Local taxation worried politicians in Sweden before the First World War. The growth of the industrial sector created greater wealth in modernised areas than agricultural production could generate. Still, certain local tasks, like public schools, were nationally defined to a certain standard. Consequently, poorer areas had to pay a relatively larger amount of income for financing the municipalities than did richer areas. That situation was aggravated by the democratic reforms following the end of World War 1. A Liberal-Social Democratic government decided to increase the standard for education and poor care, which entailed higher costs. But the reforms were not followed by a concomitant relative increase in state grants, leaving part of the financial burden to be raised locally.¹⁴ The situation was similar in the Netherlands where the government, with Minister for Finance de Geer, planned a reform of the grant system in the early 20s because of reforms on the expenditure side of the municipal budget. De Geer, however, fell before the task had been completed, and the new Minister for Finance, Colijn, gave priority to cuts in the state budget in the context of depression which also Holland experienced in the early 20s. In that situation, the municipalities had few hopes for an improvement of their situation.¹⁵

In the depression following World War 1, the reshaping of society towards industrialisation and urbanisation progressed at a slower pace than before the war. Once over, however, migration from rural areas increased. Since the migrants were of the productive generation, the income gap between the rural countryside and the industrialised towns widened even more from the mid-20s.¹⁶ The effect, of course, was that to a decreasing extent rural areas were able to finance national policy fields. The economic crisis from the late 20s and onwards heightened the pressure, and also precipitated the first financial crisis of the Welfare State.¹⁷ Since welfare measures of the period were mainly locally produced, the fiscal strain on local government soon became visible as incomes fell.¹⁸ In Sweden, as elsewhere, cost centralisation rose as an answer to the challenge coming from politicians searching for remedies. The central state increased its financial responsibility.¹⁹ Once again, the calls from the countryside were the loudest.

One problem was that there had to be some norm indicating to people what was a just tax level. Indeed, for the contemporary person such a norm existed, namely the central state income tax. That tax had in Sweden been reformed several times between 1902 and 1919, and, following those reforms, a definition of tax justice had won general recognition: taxes should hit the individuals with an equal burden. The effect was a tax system with progressivity, generous deductions for interest payments and the cost of having a family, and at the bottom a tax free minimum income.²⁰ However, the tax rates could be held at a very low level after the First World War. The depression was met by cuts in the budget, and, with the level of public expense of those years, the progressive principle allowed the central state to put the burden on people with high income. Therefore, the average taxpayer on the countryside in the late 20s found

that he paid five times as much in municipal income tax as in state income tax. The concomitant figure was only twice as high in urban areas.

In the Netherlands, the question of local taxation posed the same problem, since a local income tax also existed there. With a reform in 1929, de Geer returned to the issue with a new government and proposed a draconic solution. The autonomous local income tax was almost totally abolished and substituted for a nation wide local income tax, raised with the same percentage throughout the country and then redistributed. In doing so, de Geer followed the Weimar-model to its logical conclusion, and solved the inequality problem by measures on the income side of local government.²¹ A solution could also be sought by way of increasing the size of the municipalities or increased support of central grants. The methods were discussed in Sweden, but in contrast to the Netherlands, the path towards a reform was longer. When a solution finally emerged, the content was quite different from the Netherlands. The reasons for the differences will be discussed in the last section of this article.

The case of Sweden

Since 1843, the local income tax in Sweden had been connected to the income tax of the central state. With reforms in the national defense in 1892 and 1901, the central state in 1902 went on to reform its income tax. Also, in 1897 parliament established a committee to prepare a concomitant reformation of the local taxes. The preparatory work, however, took a long time. After a new investigation, the issue of local taxes was put forward by a Social-Democratic government only in 1920, but parliament rejected the proposition and opted for a provisional modernisation of the old system. In 1927, a Free Democratic-Liberal government tried again and lost, before the same government in 1928 could convince the parliamentarians on a codification of the provisional system from 1920, which had made the principles of local and central income taxation almost wholly compatible. However, the decision of 1928 precipitated renewed investigations, and in 1932 and 1938 the local income tax was again reformed, in 1938 following a change also of the central income tax.

The core of the debate on local finance was tax justice. In the contemporary debate that concept contained two dimensions. First, it should meet the demands of social justice of taxation, which meant justice between, and within, socially defined groups. Second, a system should be geographically just, which meant that citizens should be treated equally regardless of where in the country they lived.²² The first issue was called intra-municipal and the second inter-municipal tax justice. Following the contemporary debate, this article will begin with an analysis of the social justice of taxation.

Intra-municipal tax justice

The committee of 1897 included some of the shrewder politicians of the time.

Concluding their work, the committee opted for compatibility with the central taxation, but it also noted some peculiarities of local taxes. Municipalities were smaller than nations, and therefore the principles of justice sooner came into conflict with the question of fiscal stability. Rural areas, especially, could have problems relying on an income tax in years of failed harvest. Avoiding fiscal inadequacy for municipalities in those areas, the committee proposed that property should form a guaranteed tax base, so that the municipalities would be secured an income of 5% of the estimated value of property each year. That fiscal guarantee was justified by a reversion to the principle of interest, which was another way of labeling the principle of benefit. Property owners had a larger interest in the municipality than others did, and the committee consequently sought stability within that group.²³ The committee sensed the importance of not challenging the farmers, and the suggestions ended where the farmers found it acceptable.

The issue of local taxes, however, did not come to the fore after the committee had finished its task, since the issue of central tax reform had priority. In 1910, the Minister for Finance in position, the Conservative Carl Swartz, reopened the issue in appointing a new committee. Defining the tasks of the committee, Swartz identified himself more sharply on the principle of interest. Local taxation in rural areas ought mainly to rely on property, while an income tax would be of importance mainly for the towns.²⁴ In the following years the political debate revealed that Swartz could count on the Social-Democrats for support, but also that the Liberal Party vehemently resisted taxation after the principle of interest. Such a principle meant that the farmers were taxed without regard to their income. The discourse also showed that the Social-Democrats wanted to introduce progression in the local income taxes.

During the years of committee work the consequences of World War 1 influenced the issue. In the closed economy of the years of war, farming became highly profitable. On the other hand, inflation due to lack of goods on the market increased the cost of municipal production. Statistics showed that farms in 1900 paid half of the municipal taxes on the countryside, but no more than a fifth in 1919.²⁵

Table 2: Taxes levied on agriculture in relation to the total sum of levied local taxes on the countryside

Year	Tax
1897	52.1%
1900	44.1%
1912	29.1%
1916	28.6%
1919	21.6%

Source: BiSOS, Municipal Accounts.

Of course, the relative decline of farming mirrored the societal development towards industrialisation, but the pace was too high for contemporary non-far-

mer political representatives. The tax figures were not compatible with the structure of society:

Table 3: Occupational structure in Sweden in percentage

Year	Agriculture	Forestry	Industry	Trade	Transport	Other
1870	71	1	13	3	2	10
1880	66	1	16	4	3	10
1890	63	1	19	4	3	10
1900	56	1	24	5	4	10
1910	49	2	27	7	6	10
1920	41	3	31	9	6	10
1930	35	3	33	12	6	11
1940	27	3	37	14	7	11

Source: Carlsson-Rosén 1980:362

Since farmers in the current local tax system only contributed taxes calculated on an income of 6% of the estimated value of property, it could be argued that the higher real incomes during the war failed to appear in taxation. In such a context the Social-Democratic Minister for Finance, Fredrik Thorsson, from 1918 onwards prepared a reform of local taxation. He followed Swartz's method of objective property taxes. About one third of the countryside taxes should be borne by property, allowing the income tax to be more socially just to wage earners.²⁶ Thorsson, however, met fierce resistance from the farmers who rejected being taxed without regard to real income. First, the opposition led to the breakup of the Liberal-Social Democratic coalition government, and later in 1920 a Social-Democratic government lost on the issue of local taxes in parliament. The winning coalition consisted of Liberals and Conservatives, who followed their agrarian wings, and the recently created Farmers' League. The victors opted for the committee proposal of 1900. Local taxation should follow central taxation, but a property tax could be accepted as a fiscal guarantee. The new system raised agricultural local taxation to about the same level as Thorsson had planned. After the reform agriculture bore some one third of the taxes on the countryside. The conflict did not centre mainly only on incidence, which denotes the positive effects of taxation in society. Rather, principles in connection to incidence formed the main points for discussion.

New committees followed the 1920 decision, but they produced the same cleavage. Social-Democrats, economists and tax officials wanted universal property taxation, and the non-socialist parties furthered the provisional system of 1920. However, after 1920 the issue of social justice mainly concentrated on the guarantee tax and on road taxes, where farmers by tradition had a heavier burden than for other municipal costs. Historically, farms were estimated to produce an income of 6% of the estimated value of property, while other property only 5%. This reality settled the outcome in 1927 when a Free Democratic-Liberal government once again tempted parliament with a proposal. The govern-

ment wanted to codify the system of 1920 in a law. Parts of the Farmers' League, however, denied to give their support if the guarantee were not equalized to 5%. Since the government feared that such a measure would have the effect of shifting the tax burden overly on wage earners, it wanted to retain 6%. Rather surprisingly, the government found itself defeated in parliament by a tactical voting coalition of farmers and Social-Democrats. The provisional system of 1920, therefore, stayed another year, but in 1928, also surprisingly, the government could reach an agreement with the Social-Democrats, who abandoned their earlier preference for universal property taxes.²⁷ Also, in 1927 a majority of parliament was for a levelling of the road taxes in favour of the farmers.

With the decisions in 1920 and 1928, the local income tax became compatible with the central income tax. Real income should be the base for taxation if justice was to be achieved. The limited area of municipalities demanded some deviations from that principle of social justice, and in 1928 it was finally clear that the imposition of a guarantee within the income tax was the preferred solution for the majority of parliament. Compatibility with central taxation had meant introduction of progressive taxes in 1920. Progression in local taxation had several draw-backs, one of them being tax competition between the central state and the municipalities. In 1938, parliament finally decided to give up progression in local taxation in order to allow the central state a wider use of that principle for redistributive reasons.²⁸

Inter-municipal tax justice

The question of inter-municipal equalisation is quite complicated. A difference must initially be made between mitigation and equalisation. If some municipalities get to heavily burdened, the central state can raise its special grants for different purposes, like education and health, and thereby reduce the level of local taxation. Such measures mitigate the burdens of municipalities. However, it can also be held that the tax level ought to be more equal over the country, and in that case some method of equalisation has to be introduced. Furthermore, from a quasi-federalist perspective, inter-municipal equalisation should be paid for from the same base as local taxes are raised. That means a shift of resources from richer municipalities to poorer. Such an outcome may be produced also by organisational changes, creating larger municipal areas or introducing co-operation between municipalities. Another path is that the central state take the responsibility for equalisation, using central taxes for creating resources for equalisation.²⁹ The different methods of meeting the problem of unequal geographical burden were not politically neutral, and they are important for understanding the following paragraphs.

Around the turn of the century, rural representatives in the Liberal Party protested against the unequal burden of local taxation in different areas of the country. For smaller municipalities in agrarian areas, the cost of administering

public education, health and poor care, and road maintenance weighed relatively heavier than for richer, industrialised areas. The Liberals called upon the state to mitigate the burden of those agrarian areas. Some minor measures were taken in 1905, but in 1912 a Liberal government wanted to introduce an equalisation grant. In parliament, a majority of urban representatives defeated the government. Explicitly, the majority stated that the problem of social justice had priority before geographical justice. The countryside Liberals, however, continued their quest, and in 1917 they succeeded in getting a broad parliamentary majority for a provisional equalisation grant, with the resources provided by the central state.³⁰

However, when the Minister for Finance F V Thorsson in 1920 returned to the issue of equalisation, he proposed that the resources for geographical levelling should be raised by the municipalities themselves by way of the progressive local income tax. The local progressive income tax was not entirely a municipal tax. It could not be inserted into the basic proportional local income tax, since the outcome of such a solution would be incompatible with the principle of equality of taxation regardless of place of residence. Therefore, the progressive tax was in its essence a central tax, raised via a nationwide scale, but the collection of the tax was left to the municipalities. The resources created for equalisation then went into an equalisation fund from which they were later on redistributed. In the bill, Thorsson suggested that the fund should be founded on 90% of the progressive taxes being raised from limited companies. In proposing that method, the government recognised the fact that certain areas unintentionally benefited from the societal allocation of resources.³¹ Parliament, however, rejected Thorsson's proposal, deciding that 75% of all progressive taxation should be secured for intra-municipal needs, and the remaining 25% left for inter-municipal equalisation. In principle equalisation thus became independent from the state budget.³²

The introduction of the progressive tax for equalisation did not put an end to the geographical injustice. The revenue raised did not suffice for any large-scale levelling, and had several logical disadvantages. First, the method for creating resources meant that a person from a tax burdened area might have to pay for persons in less burdened areas. Second, progression as a principle increased geographical inequalities rather than lessened them, and the resistance from richer areas to provide money was strong. Third, the chosen method was difficult to implement efficiently. The critique formed a background to the suggestions for reform presented in 1924, when a new committee proposal came to the fore. The majority of the committee suggested a method for increasing equalisation, namely that the part of the progressive tax going to equalisation should depend on the general tax level of the municipality. In that case, equalisation would be more effective, but the method had a clear disadvantage. It would create an incentive for municipalites to raise their tax levels in order not to lose revenue. Politically, the proponents of the majority method were Social-Democrats.³³

One of the committee members was the tax official Gert Eiserman, a veteran of committee work on the issue. He pinpointed the fact that there was a constant threat towards grant maximisation in the policy of equalisation. Therefore, he proposed that the grants should be calculated on the average tax level so that the municipalities would not know beforehand where to put its tax levels. Thereby, Eiserman definitely introduced an efficiency gain. On the other hand, his proposal would just as much as the majority proposal induce municipalities to raise higher taxes.³⁴ Both Eiserman and the majority favoured equalisation in contrast to a third person in the debate. Yngve Larsson, a municipal official of the capital and former secretary of the Association of Towns, put the emphasis on mitigation of the high burden of taxation in suffering municipalities. The central state had the duty of giving the municipalities enough money to administer their national tasks. In order to enhance control, the grants should be specified, and if the state found it necessary, those grants could be differentiated for helping poorer areas. If further equalisation were needed, resources should be taken from the state budget, and not from other municipalities.³⁵ Yngve Larsson posited himself on one of the extreme positions on the issue of geographical tax justice. On the other extreme were the farmers with their quest for general redistribution of resources from towns to the countryside. In between, the Social-Democrats favoured equalisation as just, but not at the expense of limiting autonomous policy of the towns which were the major electoral base for the party. Furthermore, the Social-Democrats wished to connect equalisation with heavier taxation on the more wealthy farmers, which the nonsocialist parties constantly opposed. The Conservatives also acknowledged the need for equalisation but feared an expansion of the societal cost. In that political context, no political move was readily available for increasing a redistribution which generally seemed to stop short of need.

The system created in 1920 continued, although the part of the progressive local tax going to equalisation was also formally made a central tax in 1927. Starting in 1929, however, a new committee prepared improvements of the geographical injustice. Realising the obstacles against resource redistribution, the committee majority preferred organisational measures towards centralisation of costs through grants. One of them was mainly mitigating, namely to detach tasks from the municipalities. The effect would be lower costs for the municipalities, and therefore less burdensome taxation. The other method was more equalising, namely to create larger municipal areas. The effect, though, would not be major. In the committee, Social-Democrats as well as Liberal and Conservative urban members supported the majority proposal. It would enhance equality but also retain an interest for cost efficiency in the municipalities, though an increase in societal cost could be anticipated. From rural representatives, however, fear of the costs and a high evaluation of the historically rooted parishes induced reservations towards those measures. The agrarians still favoured equalisation grants to centralisation.³⁶

Following the depression of the early 30s, the centralisation of costs was one

method used for reaching a more just distribution of societal costs. In those years more systematic measures were postponed, but a new committee was appointed in 1936. The politicians once again delved once into the complicated area of geographical tax justice, but some new considerations had emerged. First, in the late thirties it could be envisaged that there was a majority for centralisation in the form of larger municipal units. In addition to earlier Social-Democratic and Conservative support, the leader of the Liberal Party, a reunification of the old Liberal Party which in 1923 had split into Liberals and Free Democrats, expressed his support for a merging of the existing small rural parishes. Furthermore, parliament had in 1937 begun to demand that central grants should be differentiated so that poorer municipalities were given the resources to secure that the social standard could be upheld also there. Centralisation became the key to a solution of the omni-present problem of geographical tax justice.³⁷ The 1936 committee gave priority to centralisation and differentiation of the specified central grants as the main measures. In doing so, they favoured equalisation, but on a higher level of public expenditure than before. Therefore, the conflict between rural and urban areas could be overcome. There was a gain for both parties and the overall justice in the nation would increase.³⁸

Though there is a large similarity between the 1929 and the 1936 committee thinking, it is important to note the differences. The former committee, headed by a former Liberal Minister for Finance, and also including a Conservative with experience on that post, presented the ultimate rationale for the liberal solution of the problem of inter-municipal tax justice. Realising the problems with progressive local taxes and the problems with equalisation grants, whether general or differentiated specified ones, the majority had opted for simplicity, cost efficiency, and minimal societal cost. The Weimar-solution was probably unthinkable in the Swedish political context, but the 1929 committee posited itself as close as possible to the model.

On the other hand, the 1936 committee embodied the emerging Social-Democratic society. By introducing the concept of a Peoples Home, the party leader Per Albin Hansson from 1927 tried to give the party a broader electoral base. Following the installation of the red-green agreement in 1933, the party succeeded in securing a stable parliamentary majority for a restructuring of society. Not only the Farmers' League, but also Liberals supported redistribution for achieving a higher standard of living in poorer areas. For that purpose, the politicians of parliament accepted a high degree of state control and centralisation for reaching the chosen goal. That course would heighten the total societal cost, but the majority deemed such a price justifiable. In doing so, the politicians found a way of surmounting the conflicts which earlier prevented a thoroughgoing solution. Indeed, the implementation of the new ideas belong mainly to the period after the Second World War, but the notions were already there before the war. The changing notion of society, however, should probably not be overestimated. Many of the liberal values prevailed also

in the Social-Democratic society. The consensus on the principles of a just taxation survived, as did the consensus on the need for retaining efficiency and economy in local government. On the other hand, such considerations were subsumed under the goal of a centrally governed development of society, where tax justice did not have the important position associated with the Liberal society.³⁹ The changing ideas in tax policy, therefore, pursue paths emanating from the red-green crisis solution.

Economic and political theory of taxation and the case of Sweden

System stability

A striking fact with the issue of local taxation in interwar Sweden was that the ceaseless preparations and strife on the issue did not result in an inventive restructuring of the system of local taxation. Rather, the provisional reform of 1920 modernized the old income tax to fit recent developments in the field of central taxation. Such an outcome is generally acknowledged in the literature on taxation. Tax systems are complicated and therefore not easily changed.⁴⁰ That proposition does not contradict the intuitive understanding of the agents of the interwar period. Generally, it was accepted that a future reform had to have a clear connection to the current methods of taxation. That argument had guided the 1897 committee, when they designed a guarantee system, where objective property taxes and subjective income taxes were co-ordinated. Of course, the parliamentarians of that committee knew well that tax theory dictated that the two types of taxes should be held separate. But they also knew that the farmers would not accept such a division. The Liberals used the guarantee system for solving the question in 1920, and in 1928 this was codified in a law which was to have long duration. Although constantly criticised by economists as irrational, by tax officials as too complicated, and by the Social-Democrats as unfair, that system was most convincing to a majority of the parliamentarians.

Economic evaluation of taxes

In the normative economic thinking on taxes, certain traits are generally thought positive. Taxes should be fiscally neutral, which means that they should not induce shifts in the allocation of productive resources in society. Secondly, taxes are to be buoyant, giving governments fiscal security also in periods of economic strain. With the Public Choice-thinking, it has also been strongly accentuated that taxes should be visible to the taxpayers, so that the citizens are not deluded to pay higher taxes than they think they are paying.⁴¹ If the local tax system being introduced in Sweden in 1920 is evaluated from the economist perspective, it certainly had major flaws. First, with the introduction of the progressive principle, incentives were created for moving wealth to municipalities already being wealthy. That principle also produced a tax base

strong enough to allow the wealthy municipalities to decide upon expenses never to be dreamt of in poorer regions, which also meant that the state, perhaps, as a consequence had to pay for securing the high standard also in poorer regions. There was a risk of a development of a public-goods production exceeding the optimal. In addition, the high levels of taxation in agrarian areas could lead to productive work being prohibited. The system failed also with regard to buoyancy. Certainly, the progressivity, in that sense, fulfilled its purpose, but for the agrarian areas the income tax was clearly not enough. Contemporary theory, however, maintained that in such cases resources should be transferred between areas, which, though, were not easily accomplished due to the political resistance. For the farmers the system clearly had a major flaw in the sense that the construction of a secure fiscal base, a guarantee, basically meant that incomes in rural areas were made to look higher than they were in reality. This was evident not least during the depression in the thirties when agricultural income fell way below 6%. Not surprisingly, the furious resistance of the farmers to the imposition of objective taxes outside of the income tax calculation is best analysed by the concept of fiscal illusion. If such a system was accepted, the average level of income taxation could be lowered with the outcome that it would look as if the situation was better than it really was. The Social-Democrats argued that such was the fact, because there were larger possibilities for tax evasion in agriculture. For the opposing farmers it was just a method of overtaxing the countryside.

Political evaluation of taxes

Within rational thinking, suggestions have been made that any ruler should be considered as maximizing the tax incomes for the state.⁴² That proposition may seem preponderous, but in fact, gets some validity in this study. The interwar years saw governments of Conservative, Liberal and Social-Democratic colour, and for all the governments, there was a fear of following the principle of fair taxation to its logical conclusion. Getting rid of the guarantee would, namely, be countered by an increasing pressure on the state budget. Retaining fiscal security in local taxation therefore also meant avoiding political strife on increased national taxation. The same argument covered the issue of geographical justice. Even if equalisation was justified and suggestions of methods abundant, the fear of municipalities maximising grants and the suspicion of tax evasion on the countryside continuously hampered reform.

Tax issues have some peculiarities. For example, they are regarded as complicated, and therefore also as unfitting for electoral struggle.⁴³ That proposition was to some extent verified in the interwar debate on local taxes. When the Social-Democrats decided to pursue a path of conflict in 1920, it was partly due to the convincing capacity their system should have on the farmers. The main benefit, namely, with objective property taxes kept out of the income tax was that they would allow a more effective use of deductions for the farmers with

the least income. Consequently, those farmers should be convinced to support the Social-Democrats, and to give that party entrance into the rural constituency. However, the attempt was not successful. On the other hand, there were signs indicating that within the non-socialist parties, the Farmers' League could use the issue of local taxation for gaining votes from the other bourgeois parties. The issue of road finance apparently functioned well in that respect. Also, the issue of inter-municipal equalisation could in a simple way be presented to the voters through comparison with the incidence of the state income tax.⁴⁴

In contrast to economists, politicians are less interested in rationality and visibility. Rather, they favour the viewpoint of justice, and sometimes of illusion.⁴⁵ Without doubt, the question of justice pervaded the political strife on local taxes in Sweden. However, tax justice cannot be defined in an unambiguous way, and the political discourse centred on the definition. Generally, it is also held that the politics of taxation, though certainly evoking wide statements of ideology, is to a great extent reduced to material interests of socially defined groups, to incrementality, and also to the ability of political entrepreneurs to find ingenious solutions.⁴⁶ In Sweden, a continuous inability of farmers and workers, and of farmer and other middle-class representatives, to overcome clear-cut opposing material interests during the 20s kept the issue on the political agenda. However, it also seems obvious that the restructuring of the issue in the 30s cannot be explained without recourse to ideology. By defining themselves clearly as a party for the people, a position earlier mainly associated with the Liberal fractions, the Social-Democrats founded a base for overcoming what had seemed to be unsurmountable cleavages. Certainly, such an explanation must incorporate references to individual politicians, not only as for reaching broad majorities. For example, Fredrik Thorsson paralysed attempts to reconciliations with the Liberals in 1920 by tying his own person to his local tax proposal. The Swedish debate, was furthermore dominated by a small number of party politicians specialising on tax issues. In the Dutch context, one of the Free Democrat parliamentarians, P J Oud, explained the outcome there referring to the person of de Geer.⁴⁷ Indeed, being a technically complicated issue, taxation, probably more than other issues, demands skilled politicians for making it politically workable.

Another political preference is the notion of simplicity. Indeed, economists also argue in that vein, since simplicity prevents the production of costly tax expenditure.⁴⁸ However, the issue of local taxation in Sweden demonstrates the fact that simplicity can come into conflict with tax justice. In the critique of the Social-Democratic tax system, a questioning of simplicity and justice could be co-ordinated, but so could the victorious guarantee system. After its approval, the Social-Democrats and tax officials joined in deploring the difficulties of implementing it and of its distorted justice, but its appeal to fairness made it more viable than its competitor. The same evaluation can be made of the system of geographical equalisation conquering the politicians of the 1936 committee.

Generally considered as complicated, leaving the implementation to specialised people, it nonetheless proved to be the rationale possible to convince a majority of politicians. Warnings of complications were put forward already in the interwar years, but they were disregarded.

Sweden in an European Perspective

Local taxation pervaded the political debate of the European countries from the mid-19th century into the interwar period. In Sweden, the political strife resulted in spectacular outcomes. One government cracked on the issue, and two governments were rejected by parliament when trying to solve the problem. It was earlier stated that ideology seems to be important in releasing the issue from its tensed state. Therefore, it could seem inappropriate to evoke comparisons in order to explain the Swedish case. However, certain peculiar traits of Sweden can be revealed from such a comparison. First, although the scientific debate had made it clear that a local income tax and local progressivity rather increased geographical inequality, it seemed impossible to draw any practical conclusions out of that fact in Sweden. As has been noted, a government de Geer in 1929 deprived the Dutch municipalities of the local income tax. Opposition towards that measure emerged from the Social-Democrats, who interpreted the decision as hostile to the autonomy of local government.⁴⁹ Such opposition was also uttered by representatives of city Social-Democrats in the Weimar-republic.⁵⁰ The method of lessening inequalities by curbing the autonomy of taxation for local government threatened Social-Democratic strongholds, the cities. But in the Netherlands, that party had no decisive influence on the issue. The key party was the progressive Catholic Party, a movement gathering urban and rural constituencies. In such a party, the cleavage between urban and rural could be subsumed under a general concept of fairness, just as in the Free Democratic parties both in Sweden and the Netherlands. But in Sweden, the farmers increasingly followed the Farmers' League during the interwar years. That organisation, with its conflict-oriented policy for complete equality between town and countryside, collided with the Social-Democratic reluctance towards giving away resources from the towns. In that context, the Social-Democrats and urban bourgeois groups formed a coalition halting a levelling of the inequalities.⁵¹

Following that statement, it must be explained why there was such a difference between the Netherlands and Sweden. Two factors call for attention. First, Sweden belonged to the Protestant area where worker mobilisation in secularised labour parties was, at best, tolerated by the church, and, more importantly, not counter-acted by mobilisation based on confessions. Therefore, Sweden developed a strong, united labour movement, while the Netherlands workers were divided in organisations with, at least, partly conflicting goals. But the Social-Democrats in Sweden did not gain a strength enabling them solely to determine policy outcomes. For the issue of local taxation, another object of interest is the

Farmers' League. As of the 1860s Swedish farmers had united in one movement, but that unity disappeared with the protectionist struggles in the 1880s. The farmers were mobilised in either the Conservative or the Liberal camp around the turn of the century. However, with the introduction of universal suffrage in a proportional system in 1909, the possibility of unification was once more revitalised. After some initial attempts, a unified Farmers' League had a breakthrough in the 1917 election. As a consequence, Sweden entered the inter-war years with a rather stronger farmer influence in parliament than before the war. The proportional system allowed the farmers a pivotal position on certain issues if they so wished. On the local tax issue, the farmers mostly opted for conflict with both workers and urban nonsocialist groups.⁵²

Sweden in that sense certainly differed from the Netherlands and Germany, where farmer mobilisation depended upon confession, but also from Denmark, where the Farmer Party, *Venstre*, was liberal, and the less wealthy agrarians mobilised in the Radical Party. In all those countries, the issue of local taxation could be solved with less strife. Yet on another scale Denmark, Sweden, and also Great Britain gathered on a uniform standpoint in contrast to Germany and the Netherlands. When the issue of inter-municipal inequality was met, the three former countries chose the method of contributing resources to the burdened municipalities, while intentionally retaining the autonomy of taxation. The Weimar logic was, on the contrary, to detain that autonomy. An explanation for that difference could call upon history, since in Sweden, for example, local autonomy had a historically high value which prohibited recourse to measures clearly hostile to that autonomy. Indeed, expressions referring to history are found in the Swedish discourse, but such references arguably did not determine the outcome. Rather, different outcomes are best explained by reference to the lack of ideological commitment to gather different societal groups within a movement aiming at creating a fair society. In Sweden, the Free Democrats certainly opted for such a path of justice, but the Social-Democratic and Conservative hostility limited the possibilities of such a solution. In the case of Great Britain, of course, the lack of a local income tax prevented the problem from being posed with the acuteness of other countries. The choice of measures also pertain to different conceptualisations of society. As has been shown, an extended support of tax burdened municipalities in Sweden threatened to increase the total cost of public service. To avoid that threat, the method of limiting, or abolishing the autonomy in taxation for local government was more effective. Indeed, giving strength to that argument, de Geer countered the Social-Democratic opposition to his proposal in 1929. Giving in to those demands would simply allow the richer areas once again to implement policies which would widen differences between municipalities.⁵³ Consequently, the central state would have to augment its support for poorer areas, ultimately accepting a spiral of raised societal cost. The fear that a centralisation of costs without curbing tax autonomy would strain the state budget pervaded the Swedish discourse, but did not yield the cautious outcome of the Netherlands.

The Weimar-model was without doubt a principle of justice pertaining to the liberal order of society. Of course, neither Germany nor the Netherlands, were ideal type Liberal societies, but the liberal perception of society gained widespread acceptance after the First World War. When Sweden and Denmark went the other way, the liberal hegemony had lost its appeal and the Social-Democratic society had begun to be schematised by the politicians. In that context, the problem of societal costs for welfare measures was conceptualised in quite another fashion.

Then it could of course be asked why the strife on local finance should be more severe in Sweden than in Denmark. Also here, recourse to history has been attempted, claiming that Danish municipalities had fewer tasks to fulfill than did the Swedish ones.⁵⁴ Of course, if inequality was less pronounced, the strife probably also was. In addition, it has been argued that a geographically smaller country like Denmark could more easily circumvent the problem by state provision, since state control would be easier than in Sweden. Such structural explanations could pertain also to other problems being met in this article, but such an approach fail to pose the question of policy response towards those structural facts. Accordingly, I am maintaining that the Danish case is best analysed with reference to the relations between political movements. In Denmark, the farmers were mobilised in a liberal movement, and the Social-Democrats were weaker than in Sweden. Not less important was that Danish politicians were sensitive to the position of agriculture on the world market which provided the country with its products of export. This sensitivity produced an early breakthrough for a universal, partly central state tax-financed old-age pension, since leaving the care of old people to local government would mean levying a burden on agriculture that could threaten its position on the world market. The Liberal farmers in Denmark had been far more successful than their Swedish counterparts in being relieved of their local burden. Nevertheless, in the reform period of the 1930s, Danish rural municipalities also had difficulties which caused outward migration due to evasion from taxes. The central state, however, stepped in with equalization measures in the last years of the decade.⁵⁵

Conclusions

This article has presented a short overview of the political issue of local taxation in Sweden during the interwar years. Local taxes produced intense political strife, causing the demise of one government and spectacular defeat for two others. The core of the struggle lay in the distribution of the tax burden between the countryside and the urban areas. Especially the farmers persistently sought a release of its local burden, but until the 30s, the resistance of urban political representatives prevented a solution acceptable to the farmers.

The issue of local taxes in interwar Sweden has been evaluated with regard

to economic and political theories of taxation. Normative economics certainly do not fit well with the interwar local tax system of Sweden. Inequalities in the distribution of national income were rather aggravated with the current system, and therefore did not meet the requirements of fiscal neutrality. Although the politicians tried to make the system buoyant on the countryside, these efforts can be criticised for giving in to fiscal illusion. Evaluated in accordance to political theories on taxation, the accent on tax justice in the interwar years follows the general statements of theorists. It is more doubtful whether the interwar debate validates the suggestion that tax issues do not function well as electoral issues.

Third, the political process involving local taxes in Sweden has been compared with some other European countries. It is argued that Protestant Sweden, with its proportional voting system, developed a party system with strong class-based Social-Democratic and Farmer parties. In such a context it was more difficult to find a common base for a pacification of the local tax issue, than it was in countries like the Netherlands and Germany, where confessional mobilisation created positive incentives for compromises between workers and farmers, also entailing compromises between towns and rural areas. For Sweden, it can also be said that the evolution of the Social-Democratic society in the 30s provided the ideological foundation for circumventing the zero-sum game which earlier had thwarted thorough political solutions. With the new conceptualisation, the question could be restructured as to present a majority for proposals in which all the groups supporting it could find positive values.

Notes

1. A comparative examination of the fiscal crisis of local government is presented in Sharpe 1981, and Rose-Page 1982; the question of tax revolts is elaborated in Haskel 1987. In Wilson 1991 and Winetrobe 1992 the tax proposal put forward by Margaret Thatcher is evaluated, and in Burns 1992 the views of the political opposition to Mrs Thatcher are presented from one perspective.
2. Official Committees of the State (SOU) 1991, 98:92 for the new grant system. For a clarifying review of the debate on local government in the British context, see Duncan & Goodwin 1988.
3. Page 1991:113–132.
4. Stjernqvist & Magnusson 1988:12–14. Lalumière 1981:229 stresses the ongoing anti-nomic traits of municipalities, namely on the one side a counterpart to the central state, and on the other hand an institution for functional division of administrative implementation within the central state.
5. Ardant 1971–72, I:12 and 18; II:350–359 and 494.
6. Foster et al. 1980:30 & 38. The dual classification of local government within the central state has been elaborated. Instead of the rather negative position of local government in the unitary state, it could be argued that the relations between central and local better is understood by way of inter-activity, see Stoker 1991:6–7.
7. Ibid:40–45. In economic theory the traits defining a beneficial public good are labelled non-appropriateness and non-rivalness.
8. Ibid:44–45.
9. Ibid:45–49.
10. Köster 1984:203–204.
11. Foster et al. 1980:174–175; Leppink & Leppink 1936:35–38.
12. Hentschel 1983:277–278, where the political considerations on the financial settlement of the Weimar-republic are discussed.
13. Köster 1984:152. Heyndels 1991:10 describes the development in Belgium where from the 1860s the central state started to constrain the autonomy of municipal taxation, and substituting it for grants. In 1920, the local income tax disappeared for two years, but it was reintroduced in 1922, since the depression too much strained the central budget.
14. SOU 1943, 43 for a detailed review of the issue of inequality between municipalities.
15. Rovers 1932:155–171.
16. Linders 1933:49–57.
17. Pierson 1991:114–118.
18. Foster et al 1980:89.
19. Köster 1984:378.
20. Rodriguez 1982 for a presentation of the tax history of 20th century Sweden.
21. Rovers 1932:169
22. Nilsson 1966:149–152.
23. The main contents of the committee are evaluated in Davidson 1900.
24. Swartz 1911.
25. Contributions to the Official Statistics of Sweden (BiSOS): Municipal accounts (Kommunala räkenskaper).
26. Minutes of the Swedish Parliament (Bihang till riksdagens protokoll) 1920, Government Bill (Proposition) 191.
27. One of the centrally placed civil servants has in a short article recapitulated the development from 1920 onwards from the perspective of the 50th birthday of the Municipal Tax Law; see Kuylenstierna 1978.
28. Rodriguez 1982.
29. Fornmark 1939:83 ff for an excellent survey of the issue. See also Foster et al 1980: 542–558, for a thorough analysis of the problems with grant equalisation. Compare also Lalumière 1981:227.

30. A brief survey of the secular development of the system for geographical equalisation is given in Uddhammar 1993:255–265.
31. Hamilton 1917 is an excellent introduction to the relation between societal allocation of resources and inter-municipal tax inequality.
32. Official Committees of the State (SOU) 1925:35.
33. *Ibid* 1924:53. For the critique of using progressive taxes locally, see the discussion of the negotiations of the Association of National Economy (Nationalekonomiska föreningsförhandlingar) 1924 and 1925. One of the Social-Democratic members of the committee clearly stated that he wanted more resources for equalization, see The National Archives (Riksarkivet), Committee 301, Volume 73, Document 24:10. That fact is important to note, since the following discussion could be interpreted as if the Social-Democrats were hostile to geographical equalisation. They were not, but they wished to connect it to adjustments of the social justice of taxation.
34. Official Committees of the State (SOU) 1924,54:649–670.
35. Larsson 1924.
36. In 1933, after the publication of the report of the committee, the Association of Swedish Countys held a clarifying congress on the subject, see Communications from the office of the Association of Swedish Countys (Meddelanden från Landstingsförbundets byrå, svenska) 1933, 1. The creation of larger municipalities and other forms of centralisation also produced economies of scale. The committee recognised that outcome, but they also thought that such effects would be quite limited. Certainly, some rationalisation would be possible, but the more heavy duties of the municipalities were outside the scope of scale effects. The committee notion is compatible with the theoretical discussion on the topic, see Foster et al 1980:567–569. Of course, centralisation has formed a large part of the discourse on local government reform in the 20th century, see Brans 1992 for an evaluation of the theories on that issue.
37. Some of the provisional measures were: centralisation of costs for public education 1930 and 1935; doubled progressive taxation for funding equalisation between municipalities; mitigation of the tax burden for road maintenance. Other reforms with less obvious equalisation capacity had been the introduction of an unemployment insurance in 1934, and of course the measures for creating public works and upholding the price level of agriculture through central taxation. The latter was probably the more important for the tax burdened municipalities on the countryside. Interestingly, the general equalisation grant introduced in 1917 had through the 20s reached numbers between 3 and 6 million Swedish Crowns. In the 30s, it peaked on about 17 million in 1935, notwithstanding all other measures. Furthermore, the fiscal guarantee on the countryside also peaked during the depression, reaching the level of some 30 million Crowns for farm property. Consequently, the impact of the fiscal guarantee was considerable, and to substitute it for grants costly.
38. Official Committees of the State (SOU) 1943,43:84–94.
39. The 1929 Committee did consider the method of differentiating the specified grants, but both the chairman and the secretary of the Association of Countys evaluated the method as too complicated, see The National Archives (Riksarkivet), Committee 362, Volume A 1, 1931:19/10.
40. Dahlgren & Stadin 1990:14.
41. Peters 1991:50–52; Hansen 1983:45–46.
42. Levi 1988:3.
43. Peters 1991:4.
44. From 1920 onwards, it was generally acknowledged that there existed a possible log-rolling between urban and agrarian interests, namely the issue of road taxes. However, in 1926 the nonsocialist parties gave up. Parliament notified government that the farmers had the right to relief from parts of the road taxes, regardless of whether that relief was contemporaneous with a local tax reform. The Farmers' League had pushed the issue of road taxes in the elections preceding the decision.

45. Peters 1991:55—56.
46. Hansen 1983:33.
47. Oud 1968:176.
48. Tax Expenditures:7—15; Taxation in Developed Countries:17.
49. Oud 1968:179.
50. Köster 1984:205—206.
51. Therborn 1989 makes a political comparison between the Netherlands and Sweden concerning the last century. For a statement of the centrality of the Catholic Party in the Netherlands in relations to countries like Sweden, see Luebbert 1991:248—249.
52. Luebbert 1991 presents a comparison of the three different political systems of interwar Europe: Liberalism, Fascism, and Social-Democracy. In search of the roots for that division, Luebbert enters the years preceding World War 1, and the different ways societies met rising Labour movements. Clarifying for the issue of this article is Luebbert's emphasis on the fact that a red-green agreement occurred where Social-Democrats failed to mobilise the countryside. This article has argued that the Party actually tried to use the local taxes for that purpose, but without success. After reconsidering its policies in the mid-20s, the Social-Democrats changed their pursuit, and opted for collaboration with non-socialist farmers instead of electoral conflict on a wide scale. See especially 285—290 for the case of Sweden.
53. Minutes of the Dutch Parliament, the Second Chamber (Handelingen, Tweede Kamer) 1928—1929:2018—2020.
54. Page 1991:123.
55. Rasmussen 1978:491; Jörgensen 1985:539.

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