

## **Comment on Herbert J. Schuetze and Donald Bruce: Tax policy and entrepreneurship**

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This paper presents a very interesting survey of existing theoretical and empirical work on the relationship between tax policy and self-employment. The theoretical part identifies four different important theoretical considerations regarding this relationship.

- Differences in effective tax rates for wage-earners and self-employed tend to distort the allocation of resources between these two categories
- Proportional taxes imply risk-sharing and hence, tend to increase the volume of risky activities including self-employment
- Limited loss offsets as well as progressive taxes tend to discriminate risky activities including self-employment
- Tax evasion tends to imply a distortion involving too many self-employed

The empirical part presents a survey of four different categories of studies. Finally, the paper identifies a number of gaps in the literature, which are candidates for future research.

The paper is very useful for economists interested in this and related fields. It would, however, be desirable to expand the discussion about possible policy conclusions. The paper concludes that tax policy is important for self-employment but not only magnitudes and significance but also signs differ across various theoretical and empirical studies. This conclusion is not very useful for policy-makers and should, if possible, be supplemented by more tentative policy conclusions when necessary.

My comments focus on questions which are potentially relevant from a policy perspective.

As I interpret the paper, one conclusion is that an increase in proportional taxes tends to increase self-employment as a result of more risk-sharing and more tax evasion. The conclusion questions the common claim from some lobby groups and politicians that high taxes hamper self-employment. This side-effect is likely to be welfare-

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improving if the main mechanism is increased risk-sharing, while it is likely to decrease welfare if the main mechanism is to increase tax evasion.

A second policy-relevant conclusion is that limited loss offsets as well as progressive taxes are likely to discriminate risky activities including self-employment. In order to avoid this distortion, it may be desirable to extend loss offsets as much as possible. The current Swedish tax system allows for fairly extensive loss offsets including that losses under the corporate income tax are rolled forwards and hence reduce taxes on future profits. The distortion also provides an argument for less progressive taxes, which must naturally be weighted against distributional and other considerations.

A third policy relevant conclusion is that the existence of tax evasion tends to discriminate wage-earning versus self-employment, which distorts the allocation of resources. This is one consideration of many which should be taken into account in the design of tax and auditing systems. As long as tax evasion is not fully eliminated, second-best considerations may motivate statutory tax rates for self-employed which are slightly higher than statutory tax rates for wage-earners. At the very least, it provides a rather strong argument against lower statutory taxes for self-employed than for wage-earners.

More generally, the theoretical and empirical work surveyed in this paper provides no support for the fairly common view that taxes should be lower for self-employed than for wage earners. If anything, some of the identified considerations call for lower statutory tax rates for wage-earners than for self-employed. In my assessment, these arguments are not sufficiently strong to motivate such a differentiation, however. My conclusion is instead that not only horizontal equity but also efficiency is best promoted by taxes which are as neutral as possible for self-employment versus wage-earning.

Moreover, the surveyed work provides no support for the fairly common view that taxes should be lower for small than for large enterprises. Instead, the literature surveyed in this paper does not, according to my assessment, provide convincing arguments for deviations from the neutral tax treatment of firms of different sizes

If the paper were extended to include more explicit policy-relevant conclusions of this type, it would become more important and interesting. Naturally, such conclusions should be presented in such a way that the reader understands the limitations of our knowledge.

