TAXATION POLICIES FROM A EUROPEAN PERSPECTIVE

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1. AIM OF THIS PAPER

Today, the governments of the Western Balkan countries are confronted with huge financing problems due to very low employment rates, high levels of undeclared work, low financial discipline and a lack of equity and efficiency in tax matters. As a consequence these governments depend to a certain degree on support of european and international financial institutions to fix their budgets. Such a situation is unsustainable in the long run.

The main aim of this paper is to examine the budgetary and taxation policies in Europe from the viewpoint of equity, efficiency and sustainability. We will also examine how good governance in tax matters and the fight against tax fraud and tax evasion can help to raise domestic revenue.

2. TAXATION POLICY OBJECTIVES

Adequate tax revenue is necessary to guarantee democracy, public order and the operation of the legal system.

Modern taxation should be more than just a source of revenue for the operation of the State : taxation must also enable the public authorities to contribute actively to the pursuit of economic, social and environmental policy goals.

A proper road network, an efficient public transport system, a modern health service and hospital provision, an appropriate system of education, protection of the environment and active employment and vocational training policies require the injection of large doses of public finance.

Taxation is also an important springboard for a redistribution of income among citizens. Ensuring solidarity and social cohesion in society requires major social transfers and taxation needs to play a significant role too.

Taxation is also an instrument for influencing human behaviour, e.g. in the environmental field or related to active ageing (work bonus).

Taxation policy should not be an instrument of competition among governments in order to attract investment. A policy of this kind leads to tax dumping and undermines the basic goals of tax policy.

One important prerequisite for the achievement of these tax policy objectives in an efficient management of public resources, an efficient operation of public services and the provision of quality services for the consumers of these services.

3. PRINCIPLES OF TAXATION

Taxation policies must meet a series of important criteria.

First of all, taxation should be a subject for concertation with the social partners at all levels, including at European level. In particular in view of the heavy tax burden borne by them, workers wish to have their say in defining tax policy.

Secondly, taxation should be conceived in a fair manner so as to ensure tax equity. Currently, labour income is too heavily taxed in comparison with consumption and income from capital. Furthermore, salaried labour is too heavily taxed in comparison with self-employed labour as a result, in particular, of the considerable leeway enjoyed by the self-employed and members of the professions in determining their taxable earnings.

Thirdly, closely linked to the question of tax equity is the question of tax efficiency. It is not enough that the tax system should be equitably devised : it must also operate efficiently and the levying of taxes must be guaranteed by procedures that actually work.

Fourthly, taxation must also be functional, i.e. the tax maeasures must be concieved in such a way that they lead to the achievement of the goals pursued.

Fifthly, the tax system must be simple and transparent, easy to administer, enabling the tax authorities to concentrate their efforts on the work of checking and control. Transparancy must be such as to enable taxpayers to understand the logic and mechanisms of the system.

Sixthly, the tax system must also be consistent with the other policies conducted.

Seventhly, taxation should respect the principles of specificity and subsidiarity, that is, the different levels of government should each be given their own powers to levy taxes in accordance with their responsibilities and the nature of the problems. Taxes which direcly affect, or are directly affected by, other Member States' behaviour should be the subject of basic rules agreed at European or international level. Examples of this kind of taxes are e.g. corporation taxes and taxes on income from savings (interests, dividends).

4. THE IMPORTANCE OF GOOD PUBLIC GOVERNANCE IN TAX AND BUDGETARY MATTERS

The design and succesful implementation of a sustainable tax system requires sound and stable public budget governance practices.

According to Alex Matheson (OECD) (1) good governance refers above all to the settings within which public policies are decided and executed, not per se to the public policies themselves.

Effective public governance should provide
- coherence between different policy objectives;
- an environment in which people are treated fairly and equitably.

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(1) Matheson A., "Better public sector governance : the rationale for budgeting and accounting reform in Western Nations", in Models of Public Budgeting and Accounting Reform, OECD Journal on Budgeting, Volume 2, supplement 1

Good public governance in the field of public budgeting and financial management requires :

a) fiscal transparancy, meaning an open fiscal process (with e.g. info on de-budgeting of expentiture or on mandates given to sub-central governments) and information on the economic assumptions used to construct the budget (often governments use too optimistic economic growth estimates);

b) accountability, meaning independent control on the expenditure, the financial management and the respect of procedures (e.g. public procurement) in order to avoid abuse of power by individuals or groups;

c) responsiveness, meaning the capacity to respond in a flexible way to unforeseen national or international changes (e.g. lower than expected economic growth);

d) future oriented, meaning taking fully into account future costs (public debt, ageing populations) and recognising the future fiscal consequences of current policies (e.g. in the field of public employment) and behaviour (e.g. environmental degradation) in order not to overburden future generations.

Good governance in the field of budgets and taxation policies - both at the political, institutional and bureaucratic level - can only work if there is a supportive culture for rule compliant behaviour oriented towards the public interest.

Achieving this culture requires a lengthy, continuous and gradual process of change in attitudes and values. In the absence of such a culture there will be no trust in governments and it will be difficult to convince the citizens to pay the taxes due.

5. THE EUROPEAN BACKGROUND TO BUDGETARY AND TAXATION POLICIES

Since 2008 Europe is faced with a financial and economic crisis. What started as a bank crisis became soon a fiscal crisis. In the beginning most EU governments mobilized considerable financial resources through economic stimulus programmes (e.g. public investments) and automatic stabilizers (e.g. social welfare) for counter-cyclical policies. Social expenditures increased whilst revenues (taxes and social contributions) diminished. Public budgets came under high fiscal stress : deficits grew and debts exploded.

In 2009, the budget deficit was -6.8% on average in EU 27 (- 6.3% in the Eurozone), in 2010 the deficit was on average 6.4% in EU 27 (6% in the Eurozone). Between 2007 and 2012 public debt (as % of GDP) increased on average by 24.3 %points in EU 27 (and by 22.3% points in the Eurozone).
For 2013, the European Commission expects the average debt rate in the Eurozone to increase to 95% of GDP.

The EU (together with the ECB and the IMF) reacted by granting aid to countries in difficulties (via the European Financial Stability Facility - EFSF - and the future European Stability Mechanism (ESM) and especially by the introduction of the new European economic governance (European Semester, six pack, Europ Plus Pact and Treaty on Stability, Coordination and Governance) which increased the European supervision of national economic and fiscal developements.

The European Semester aims at the ex-ante coordination of national economic and labour market policies.

The Euro Plus Pact is intended to improve competitiveness and employment, public budgets, the financial situation of the social security systems and the stability of the financial sector.

The Treaty on Stability, Coordination and Governance is known as the European Fiscal Compact. This intergovernmental treaty, concluded outside the EU legal framework, is signed by 25 EU Member States (not by UK and Czech Republic) and is implemented as from 1.1.2013. This treaty introduces the "golden rule" of the balanced budget.

Important provisions of this Treaty include :

a) coordination : the obligation for governments to submit for ex-ante discussion every big economic policy reform;
b) governance : institutional novelties like the informal Euro-summits and the Euro-governance meetings,
c) stability : - budgets should be balanced or in surplus
   - general budget deficit < 3% GDP and
   - structural deficit limit of 0,5% GDP (if debt is < 60% GDP , 1% GDP)
   - public debt < 60% GDP
   - if > 60%, yearly cut of 1/20 th of surplus
   - if "excessive deficit", structural reforms are imposed by EC
   - if reforms are not implemented, eventual financial sanctions.

Following the new European agenda oriented towards fiscal consolidation (2) stimulus policies were replaced by austerity programmes, the size of which was estimated at 0.9% of GDP in EU 27, both in 2010 and 2011 (3).

Most fiscal adjustment programmes, especially in the eastern and shouthern European countries and Ireland, focus on public spending reductions in investment, social welfare, health and unemployment benefits, pensions, public sector employment and wages and on revenue increase, mainly via a rise of consumption taxes but also via higher personal and corporate income taxes, less tax expenditures and by improving tax compliance (4).

The first experiences with the European Semester indicate an accelleration of public deficit reductions (from -6.8% GDP in 2009 to -3.8% in 2012 in EU 27) and an increase of the effectiven retirement age. As a consequence of the austerity packages and the falling investment- and growth rates the pressure on the labour markets increased. Unemployment rates went up from 7.1 % in 2008 to 9.0% in 2009 (average EU 27); in the Eurozone the figures are 7.6% in 2008 and 9.6% in 2009. For 2013 the EC expects a further increase to 11.8% in the Eurozone. The unemployment is especially dramatic amongst young and low qualified workers.

Given the further deepening of the economic crisis European Commissioner Olli Rehn wrote mid february 2013 to the Finance Ministers of the Eurozone announcing that the rebalancing of their budgets may go more slowly than originally planned. This is also a modest concession to the trade unions which criticised since years the quasi unilateral austerity approach of the EU and the governments in the fight against the crisis. The trade unions have argued since the beginning of the crisis for a more balanced approach with also room for investments in economic growth.

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(2) Fiscal consolidation is defined as concrete policies aimed at reducing government deficit and debt accumulation.
(3) Theodoropoulou S. and Watt A. (2011) ," Withdrawal symptoms : an assessment of the austerity packages in Europe", ETUI working paper, 2011.02, Brussels.
(4) Bieling H-J, (2012), "EU facing the crisis. Social and employment policies in times of tight budgets" , Transfer, vol. 18, nr. 3, ETUI, Brussels.

6. GOVERNMENT REVENUE AND EXPENDITURE

In the Eurostat statistics general government revenue and expenditure covers all levels of government : central, state, provincial and local government, as well as social security funds.

In 2011 total government revenue in EU 27 amounted to 44.7% of GDP and expenditure to 49.1% of GDP (weighted averages). In the Eurozone revenue reached 45.4% of GDP and expenditure 49.5% (5). The difference between total revenue and total expenditure equals net lending/net borrowing.

The main components of government revenues are taxes and social contributions.

In 2011 taxes made up 58.2% of total revenue in EU 27 (55% in the Eurozone). Social contributions amounted to 31.1% of total revenue (34.6% in the Eurozone).

There are big differences amongst Member States : the Danish government gets 84% of its revenue from taxes whilst in Hungary, Czech Republic, Slovakia and Slovenia taxes make up less than 50% of governments' revenue.

As to the general government expenditure we find the highest rate in % of GDP in 2011 in Denmark with 57.9%, followed by France (6) (55.9%), Finland (54.0%), Belgium (53.3%) and Sweden (51.3%). Norway spent 44.6%. The lowest expenditure was registered in Bulgaria (35.2%), Slovakia (37.4%), Lithuania (37.5%) and Romania (37.7%) (7)

General government expenditure can be classified by economic function or by type/nature. The functional classification is based on ten main categories (division known as "COFOG 1" level - which stands for Classification on the Functions of Government). The classification by nature uses a list of four ESA 95 categories (ESA 95 is known as the European System of Accounts). In this paper we will limit us to the most relevant classification, namely the functional one.

7. FUNCTIONAL CLASSIFICATION OF GENERAL GOVERNMENT EXPENDITURE

In all EU Member States the social protection function is the most important : its spending reached 19.9% of GDP on average in EU 27 in 2010 (as compared to 18,2% in 2002). This function alone represents 39.4% of total government expenditure. Spending on health (medical and pharmaceutical products, outpatient and public health services, etc) was 7.5% of GDP in 2010 in EU 27 (6.4% in 2002). This represents 14.7% of total expenditure. That means that social protection and health together were responsible for 54.1% of total public expenditure on average in EU 27 in 2010.

Spendings for the other functions were (on average) : for general public services : 6.5% of GDP; education : 5.5%; economic affairs : 4.7%; public order and safety : 1.9%; defense : 1.6%; recreation, culture, religion : 1.2%; housing : 1% and environmental protection : 0.9%.

Over the period 2002-2010 average spending (as a % of GDP) increased for all functions in EU 27, except for general public services (slight decrease) , housing and defense (status quo). The highest increases were noted for economic affairs (+ 17.5%), health (+ 17.2%) and social protection (+ 9.3%).

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(5) Eurostat, Government finance statistics. From Statistics Explained, data from october 2012
(6) In 1880, France spent only 11.2% of its GDP on public expenditure; in 1960 this had increased to 34.6%
(7) Eurostat, General government expenditure : analysis by detailed economic function, Statistics in focus, 33/2012.

Large differences exist amongst Member States as to the importance attributed to different functions (figures for 2010 as % of GDP).

As to social protection, the top 5 in terms of spending are Denmark (25.4% of GDP), France (24.2%), Finland (23.9%), Austria (21.7%) and Sweden (21.6%). The bottom 5 is reserved for Cyprus (11.7%), Slovakia (12.3%), Bulgaria (13.5%), Czech Republic (13.7%) and Lathua (13.8%). Norway spent 17.8%.

As to health, the top 5 includes Denmark (8.5% of GDP), Ireland (8.5%), the Netherlands (8.3%), Austria (8.1%) and UK (8.2%). In the bottom 5 we find Cyprus (3.3%), Romania (3.6%), Lathua (4.3%), Bulgaria (4.8%) and Luxembourg (4.9%). Norway spent 7.5%.

General public services include expenses related to executive and legislative bodies (except defense, police, courts, prisons and fire brigade services) and interest payments on government debt. The top 5 includes : Greece (11.1% of GDP), Cyprus (10.7%), Hungary (9.3%), Belgium (8.4%) and Italy (8.3%). On the bottom are represented Estonia (3.2%), Ireland and Bulgaria (both 3.9%) and Lathua, Luxembourg and Romania (all 4.5%). Norway spent 4.7%.

Education expenditure goes for more than 60% to the compensation of employees. The top 5 includes Denmark (8.1% of GDP), Cyprus (7.5%), Sweden and the UK (both 7%) and Estonia (6.8%). On the bottom we find Romania (3.4%), Bulgaria and Greece (both 3.8%), Germany (4.3%) and Italy together with Slovakia (both 4.5%).
Low expenditure on education indicates in general a relative public under-investment in either pre-primary or tertiary education facilities or in both.
Norway spent 5.9%.

8. TOTAL TAX REVENUE (INCLUDING SOCIAL CONTRIBUTIONS)

It is fair to say that the EU 27 area is a high tax area with an average overall tax ratio of 38.4% of GDP (weighted average) in 2010. This is more than 50% higher as in the US (24.8% of GDP). Over the period 2000-2010 the overall tax ratio decreased by 2.0 points (8).

Inside the EU the differences in global tax levels between Member States are quite significant. In Denmark (47.6%), Sweden (45.8%) and Belgium (43.9%) the global tax burden is 60 to 75% higher than in Lithuania (27.1%), Romania (27.2%), Lathua (27.3%) and Bulgaria (27.4%). All new Member States have a global tax ratio which is below the EU average. These large differences depend mainly on social policy choices : public versus private service provision in the field of pensions, health insurance, etc. and strong or weak developed welfare states.

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(8) These figures are based on the report Taxation trends in the European Union, edition 2012, published by Eurostat. The Eurostat serie "statistics explained" gives slightly higher rates due to the use of a different methodology. The overall tax ratio is calculated by Eurostat on the basis of a denominator (GDP values) that includes estimates of production by the informal sector. This explains why low overall tax ratio's can be due to low tax rates but also to high tax evasion.

9. TAX STRUCTURE

Tax systems rely on three pillars : by type of tax we distinguish : - direct taxes which include personal income tax, corporate income tax and other income and capital taxes (inheritance and gift taxes); - indirect taxes, including VAT, excise duties, consumption taxes, taxes on products and production; - social contributions of employees, employers and self - employed.

Taxes can also be classified by tax base : then we distinguish between consumption - , labour - (employed) and capital taxes.

And finally a subdivision is possible by level of government : central-, state-, and local government, social security funds.

Specific statistics are also available for environmental taxes (including excise duties on energy products, taxes on transport vehicles and pollution taxes) and for taxes on property (on the basis of OECD data).

9.1. Tax revenue by type of tax

Direct taxes allow greater redistribution than indirect taxes : therefore they tend to be more important in countries with a more pronounced redistribution objective. In these countries the top personal income tax rates tend to be higher too.

In the EU 27 indirect taxes, direct taxes and social contributions have today more or less the same weight in total tax revenue : each of them counts for approximately 13% of GDP (9). However, the new Member States have a different structure compated to the old Member States : the new MS rely much more on indirect taxes whilst the old MS (and Norway) have higher shares of direct taxes. The lowest share of direct taxes are recorded in Lithuania (only 17.4% of the total), Bulgaria (18.8% of the total), Slovakia (19.1%), Estonia (19.9%) and the Czech Republic (20.8%) : all of these countries have adopted a flat rate system.
The Nordic countries, UK, Ireland, Belgium and Italy all have high shares of direct taxes (between 62.7% and 34.9% of total tax revenue).
As to social contributions, the picture is more diversified : here we find old and new MS amongst the top 5. Remarkable feature is that France and Germany have a high share of social contributions (above 39%) and a relatively low share of direct taxes (below 30%). The majority of new MS have shares above the EU 27 average.

The European Union has been very active in the field of indirect taxes by setting minimum rates for VAT (6 th directive). Efforts have also been made to harmonise corporate taxes (rates and tax base) , but until now only limited progress could be made on the question of the corporate tax base.

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(9) Compared with 1970 (EURO 6) direct taxes have considerably increased from 8.9% of GDP to 12.6% in 2010. Social contributions increased from 11.7% in 1970 to 12.7% in 2010. Indirect taxes remained at the same level : 13.0% in 1970 and 13.2% in 2010.

9.2. Tax revenue by tax base

9.2.1. Taxation of consumption

The economic and financial crisis has had a strong impact on consumption taxation : revenue raising measures since 2009 were indeed heavily concentrated on consumption taxes (VAT and taxes on energy, tobacco and alcohol). After two years of decrease the Implicit Tax Rate (ITR) on consumption increased again sharply in 2010 and further in 2011 and 2012. In 2010 consumption taxes represented 28.7% of total tax revenue in EU 27 (27.0% in Norway).

VAT is the largest component of consumption taxes (>50%). Taxes on energy, tobacco and alcohol make up around one quarter of revenue from consumption taxes in EU 27. Bulgaria raises from alcohol and tobacco excise duties about five times as much revenue (in % of GDP) as the Netherlands, which is far beyond the difference in tax rates.

VAT standard rates have often increased from 2009 onwards. The average standard rate has increased by 1.5 points in four years time and stands currently at 21% in EU 27. Not less than 18 EU Member States have increased their standard VAT rates in the period 2009-2011 and Hungary went up to a top rate of 27% in 6 years time.

Tax compliance on VAT is low in EU 27. In 2010, exemptions, reduced rates and evasion resulted in only around 50% of the theoretical VAT revenues being collected. The VAT revenue ration (10) was as high as 92% collected in Luxembourg and as low as 36% in Greece.

9.2.2 Taxation of labour

The tax burden on labour is essentially composed of personal income taxes (PIT) and social security contributions. In 2010, labour taxes accounted for 51.2% of total tax revenue in EU 27 (41.5% in Norway).

Despite the broad consensus in the EU on the need to lower the tax on labour and to shift the burden to other production factors, the ITR on labour decreased only by 0.7 % points in EU 27 between 2000 and 2010 (from 36.7 to 36.0 %). The 12 new Member States decreased their tax burden on labour stronger. In 2010 the downward trend was reversed and the tax burden on labour started to rise again in more than half of the MS. In several new MS (Hungary, Romania, Bulgaria) the burden was further reduced. The lowest ITR on labour in 2010 is found in Bulgaria (24.4%), Portugal (23.4%) and Malta (21.7%); the highest tax burden on labour is registered in Italy (42.6%) and Belgium (42.5%). (The ITR on labour in Norway is 36.1 %)

The top personal income tax (PIT) rate amounts to 38.1% on average in 2012 in EU 27. Within the Union, the rate varies from 10.0% in Bulgaria to 56.6% in Sweden and 55.4% in Denmark. Most new MS have below average top rates (exceptions are Slovenia and Cyprus) : the lowest rates are observed in Bulgaria (10.0%), the Czech Republic (15.0%), Lithuania (15.0%) and Romania (16.0%), all of which have flat rate taxes.

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(10) The VAT revenue ratio compares the actual VAT revenue with the theoretical one, which would arise if the standard VAT rate was applied to total final consumption.

Since 1995 there has been a quasi general downward trend in top rates : between 1995 and 2009 the average top rate has gone down by more than 10 % points (from 47.4 to 37.2%). Since 2010 the top rate went up again. The biggest reduction of the top rate took place in Bulgaria (-40.0% points), the Czech Republic (- 28.0%), Romania (-24.0%) and Slovakia (- 23.0%).

Despite the strong reduction of the top PIT rates, the ITR on labour declined only marginally. Besides the top rates, also the income level at which they are applied matters. The effective tax burden depends also on the progression of the PIT rates and on the tax allowances and tax credits applied.

The PIT accounts only for one third of labour taxes. In EU 27 on average about two thirds of the ITR on labour consists of non-wage labour costs paid by employers and employees (mainly social contributions). In 2009 36.7% of social protection receipts in EU 27 came from employers and 20.1% was paid by employees (governments contributed 39.1%).

In order to boost the employment of low wage earners, governments have often reduced the tax wedge for low skilled workers. For workers at two-thirds of average earnings the tax wedge was reduced between 2000 and 2010 by 3.0% points on average in EU 27 (from 39.0% to 36.0%). Reductions were largest in Sweden , the Netherlands, Hungary, Finland, Slovakia and Bulgaria (all > 6% points).

The degree of progressivity of the personal income tax system can be assessed by comparing the tax burden faced by single persons earning 67% of average wage with that faced by their counterparts earning 167% of the average wage (11). The Netherlands have a strong progressivity with 5.2 % tax burden on gross wage earnings for a person with 67% of average earnings and 28.1% burden for someone with 167% of average earnings. The figures for Norway are respectively 17.8% and 27.9%, indicating a less progressive system. Countries with a flat tax system have in reality also a progressive system due to the (basic) tax free part of the earnings : e.g. in the Czech Republic the burden is 7.9% for persons with 67% of a.e. and 15.2% for those with 167% of a.e.

9.2.3 Taxation of capital

In 2010 taxation of capital delivered on average 20.4% of total tax income in EU 27 (31.5% in Norway). Taxes on capital include taxes on corporate income (6.4% of total tax income in EU 27 and 13.6% in Norway), taxes on capital income from households (2.1% of total in EU 27 and Norway), taxes on the income of self-employed (5.2% in EU 27 and 2.4% in Norway) and taxes on stocks of capital and on wealth (6.6% in EU 27 and 13.4% in Norway).

From 1995 until 2007 the ITR on capital increased in EU 25 from 26.5% average to 32.5%. Since then, the ITR went down to 27% in 2010 (in Norway the ITR on capital increased continuously from 38.8% in 1995 to 44.9% in 2010).

Taxation of corporate income is a major component of capital taxation. Its share in total tax income in EU 27 grew from 5.9% in average in 1995 to 8.7% in 2007 and decreased to 6.4% by 2010.

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(11) See OECD (2012), Taxing wages 2010-2011.

Most countries have two statutory rates for corporate income : a standard rate and a reduced rate for small business. The standard statutory tax rate on corporate income varies between a minimum of 10% (in Bulgaria and Cyprus) and a maximum of 36.1% (in France). The new Member States have in general low rates. Since 1995 the average EU 27 statutory rate came down from 35.3% to 23.5% in 2012.

Besides the statutory rate there is the effective rate. The average effective tax rate on corporate income (EATR) was 21.3% in 2011 in EU 27. The EATR was the lowest in Bulgaria (8.9%) and the highest in France (32.8%). In the 12 new MS the EATR was 16.4% on average whilst in the 15 old MS the average EATR was 25%. As it is the case for the statutory rate, also the effective rate showed a significant downward trend over the last two decades.

One of the major reasons for this decrease in corporate tax rates is the competition amongst governments to attract foreign investments. The enlargement of the EU has only reinforced this tendency, given the absence of any corporate tax harmonisation in the EU and the fact that the new MS often introduced (flat rate) taxes at a very low level. This stimulated the race-to-the-bottom in the EU.
Furthermore, the possibility for companies to carry forward their losses and to compensate them with the benefits of following years, further reduces the corporate tax revenues. If one adds to that the numerous special tax constructions and reliefs offered to international companies, it should not be surprising that in most countries the effective corporate tax rates are lower than the statutory rates and that the biggest multinational companies hardly pay any tax.
As an example, we can refer to the 25 biggest companies established in Belgium (total capital of 340 billion Eur), which made a profit of 25 billion Eur over 2011 and which paid 0.7% corporate tax. This is a clear indication of massive tax evasion and possibly also of tax fraud.

It seems that the OECD and the G 20 realise that this can no longer go on and that the loopholes have to be closed.

As to the taxation of capital income of households (2.1% of total taxation income in EU 27 and Norway), it is important to indicate that the EU saving directive established an automatic exchange of information between tax authorities of the EU Member States with regard to interest payments to citizens of other Member States.

Finally it is worth mentioning that 11 MS of the EU have decided on 22 january 2013 to introduce a common Financial Transaction Tax (Tobin tax). This tax will be introduced as from the 1st of January 2014 and will be 0,1% on the transaction value of shares and bonds (0,01% on derivates).

9.2.4 Environmental taxation

Environmental taxes are "the" taxes of the future. Originally, energy and transport taxes (which are the two main environmental taxes) have been introduced purely as revenue raising instruments without any environmental purpose. Today, policy makers realise that environmental taxes can deliver a "double dividend " : boosting the employment (by shifting the tax burden from labour taxes) and improving the quality of the environment by influencing the behaviour of consumers and producers (" the polluter pays " principle). The EU is promoting environmental taxes.

Environmental tax revenue statistics have to be interpreted with care because of an important implicit paradox : indeed, countries with a large share of renewable energy may have a lower ITR on energy than countries that rely largely on carbon-based energy sources, simply because renewable energy sources are often subject to lower tax rates. Countries with high revenues from eco-taxes can be the most polluting whilst on the other hand low income from environmental taxes can be an indication of a strong care of the environment.

Environmental taxes generated in 2010 6.2% of the total tax revenue in EU 27 (2.4% of GDP). Compared with the revenue in 1995 (2.7% of GDP), the income from environmental taxes has decreased by 0.3% of GDP by 2010. The highest share of environmental taxes in total tax revenue was recorded in Bulgaria (10.7%). In terms of share of GDP, Denmark and the Netherlands headed the ranking with a revenue of 4% of GDP.

Energy taxes (including taxes on transport fuels) represented 74.9% of environmental tax revenue in EU 27 in 2010, transport taxes (taxes on vehicles) 21.2% and pollution and resource taxes 3.9%.

9.2.5 Taxation on property

Taxes on property include : recurrent taxes on immovable property, recurrent taxes on net wealth,, estate, inheritance and gift taxes, taxes on financial and capital transactions (12), other recurrent and non-recurrent taxes on property.
Taxes on property are interesting in the light of the need to shift the burden away from labour taxes. Taxes on immovable property are one of the least detrimental to GDP growth. Recurrent taxes on property offer also the advantage of a high stability of tax revenue, which facilitates budgetary planning. And since the taxes on property are relatively low in many countries, there is room for increases.

On average, in EU 27, taxes on property deliver 3.6% of total tax revenue (2010). Taxes on property are the highest in the UK (11.9% of total taxes), France (8.1%), Belgium (7.1%), Spain (6.7%) and Ireland (5.6%). They are the lowest in Estonia (1.0%), Austria (1.2%) and the Czech Republic (1.3%).

10. SPECIAL FEATURE : FLAT RATE TAXES

The issue of flat rate taxes on personal and/or corporate income has been debated since the publication of the book "The Flat Tax" by Robert Hall and Alvin Rabushka in 1983. The experiment with flat taxes in Europe started in 1994 with the introduction of a uniform tax rate of 26% on personal incomes in Estonia. Since then, many central and eastern European countries as well as Balkan countries followed that example.

It is important to mention that "the" flat tax does not exist : in practice, rates and other characteristics (tax allowances, tax credits) of the flat tax systems differ.

Contrary to what people think, flat taxes are not always low taxes : in Lithuania e.g. the rate is 33% compared to the 10% rate in Bulgaria and Macedonia.

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(12) see point 9.2.3 on the Financial Transaction Tax (Tobin tax).

In practice, the flat tax is far from flat : due to the tax-free allowance, the flat tax gets a progressive character until the flat rate is reached (known as "the Bentham progression", named after the philosopher Jeremy Bentham).

Proponents of the flat tax use several arguments in favour of that type of tax : flat taxes would reduce the burden on labour and stimulate labour supply, would avoid the move of high-wage workers by reducing the tax on high wage-earners, would make the income tax system less complicated, more transparent, easier to administer with lower compliance costs, would automatically result in higher or at least the same tax revenue due to the effect of the Laffer curve (lower tax rates = more hours work and lower tax evasion and fraud = more tax income), and last but not least, would attract Foreign Direct Investment (FDI).

However, realities and (rare) empirical studies show that simple taxation is not necessarily good taxation.

The most interesting feature of flat taxes is indeed its transparancy for workers. It is also possible that flat taxes are easier to administer because of the removal in many cases of (complex) tax deductions and tax credits and their replacement by a general tax allowance. It should however be noted that the expected savings for the tax administrations are often over-estimated.

As to the revenue effect of the introduction of flat taxes, it could be observed that in certain countries, tax revenues have indeed increased. However, contrary to what proponents of the flat tax arue, research (13) has not found Laffer effects or sizeable labour supply effects of the switch to a flat tax. A large part of the outcome seems to be the effect of the parallel introduction of stricter rules to combat tax fraud and to improve compliance. The experience with the introduction of the Russian flat tax in 2001 supports this thesis.

In their article "Demythologizing the Russian Flat Tax" (14), C.G.Gaddy and W.G.Gale describe how Russia faced a huge debt crisis in 1998 due to its very primitive tax system and its weak administration and enforcement. President Yeltsin ordered a report on the extent and reasons of the "payment crisis", the low rate of tax collection in Russia in 1997-1998. It was found that the largest enterprises of the country paid less than 8% of their tax bill in cash ! 29% of the taxes were not paid at all and 63% were paid in the form of offsets and barter goods.

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(13) Carone, G., Schmidt, J.H. and Nicodème, G. (2007), Tax revenues in the European Union : Recent trends and challenges ahead, E.C. Economic papers, nr. 280, May 2007, p.18 with reference to Keen M., Kim, Y.and Marsone, R. (2006), the "flat tax(es)" : principles and evidence, IMF working paper, nr. 06/218.

(14) Tax Notes International, March 14, 2005, p. 983.

On the basis of the available research findings Gaddy and Gale drew five conclusions concerning the effects of the Russian personal income tax reform :

1. the introduction of the flat tax on personal income (rate of 13%) was part of a comprehensive set of fiscal reforms undertaken after the debt crisis of 1998 (e.g. the tax rate on dividends went up from 15% to 30%; the corporate tax rate of 30% remained but municipalities were allowed to impose a sur-tax of 5%, increase of excise duties on alcohol and fuel);

2. the changes in tax administration and enforcement besides other structural changes, were significantly more fundamental and sweeping than the change in tax rates;

3. economic growth began well before the reforms were introduced. GDP grew twice as fast before the reform as it did after the reform (GDP grew 10.6% per annum during the six quarters before 1.1.2001 and 4.7% per annum in the six quarters after that date);

4. microeconomic data suggest that the rate reductions had little if any effect on labour supply;

5. although there was a significant increase in compliance following the 2001 reform, it is most probably attributable to changes in the administration and stricter enforcement of the tax law (e.g. by increasing the power of the tax enforcement agencies and of the tax police : in Moscow, the tax police remitted double the amount in 2001 from tax evaders than they did in 2000).

As to the effect of a flat tax on labour costs, it should not be forgotten that the effective taxation on labour depends also from social contributions and these contributions have generally gained importance in countries having adopted a flat tax structure.

Perhaps the most important aspect of the introduction of a flat personal income tax is the fact that such tax is not neutral in terms of redistribution and tax revenue for governments. The impact of the flat tax on the income redistribution and on the income of the state depends not only on the rate, but also on the level of the basic tax allowance at the bottom of the income scale , on the amount of the accepted tax credits and on the maintenance yes or no of a special tax reduction for persons on social benefits.

A study by Decoster and Van Camp (university of Leuven) (15) examined different scenarios in Belgium. They found that in case of the introduction of a flat tax rate of 25% without basic tax allowance and only a reduction of the tax base for professional expenditure, the income redistribution would decrease by 69%. The 3 lowest income deciles would loose between 20.0 and 23.7% of income and the top (10) decile would win 12.3%. In case of the introduction of a basic tax allowance and 25% flat rate tax, the 4 lowest deciles would loose between 0.9 and 6.2% and the top 3 deciles would win between 11.6 and 16.7%. The tax revenue would decrease by 26.8%.

In order to achieve revenue neutrality in Belgium, the flat rate would need to be as high as 39.5% (with a reduced tax for people on social benefits). Even then, the redistribution effect of the tax would erode with the biggest benefit for the top deciles.

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(15) Decoster, A. en Van Camp, G. (2005), Hoe vlak is onze taks ? Is een vlaktaks "fair" ?, KUL, Leuvense Economische Standpunten, 2005/110.

The study by Fuest, Peichl and Schaefer for Germany (16) on the effects of a revenue-neutral flat tax on the German economy, arrives at the same results. They found that all scenarios - combining a flat rate and an allowance - yield an increase in inequality and redistribution in favour of the highest incomes. In terms of

And finally there is the argument that a flat tax system would attract FDI. Taxation is indeed one of the determinants of investment. However, other determinants are equally or even more important. The EC enumerates : the existence and quality of economic infrastructure, the availability of qualified workers, the otlook in different markets and countries, the geographical accessibility of markets, transport costs, environmental standards, wage levels, social security systems and the overall attitude of government (17). And we could add the legal security and the stability of governments and of rules.

Our conclusion is that the flat tax is a nice idea, but unfortunately not more than that. There are better ways to achieve the pretended advantages of the flat tax without violating the equity principle which characterises progressive taxation.

11. POLICY CONCLUSIONS

As this paper illustrates, the tax systems in the EU Member States (MS) have more differences than similarities. Differences persist not only concerning the total tax revenue, but also concerning the tax structure, the tax rates and the definitions of the tax bases. The 15 "old" MS rely on average much more on direct taxes than the 12 "new" MS, which rely more on indirect taxes. Even for those taxes where the EU has managed to harmonise to a certain degree the tax base and the tax rates (VAT, excise duties), differences remain. Especially in the field of direct taxes, and in particular the corporate and other capital taxes, the EU has made a lot of proposals, but hardly any progress towards a common tax policy. The fundamental reason for this state of play is that tax policy decisions in the EU require unanimity in the Council of Ministers and governments tend to consider taxes (and social protection), and in particular corporate taxes, as a national economic policy instrument.

In the absence of a global European harmonisation in the field of corporate and other capital taxes and of a strong international cooperation between tax authorities in the framework of OECD, tax competition and dumping, tax evasion and fraud will continue. Governments should realise that, without international regulation and cooperation, they will all be the loosers at the end. Recently, there are indications inside the EU, the OECD and the G20 that action will be taken in order to strenghten the international cooperation in order to reduce the international tax evasion and to make sure that international companies pay their share of the tax burden. It cannot be that bilateral agreements or EU directives intended to avoid double taxation of company profits end up by producing no taxation at all!

In the meantime, national governments can do a lot themselves to implement the principles of good public governance in budgetary and tax matters. The better the governance, the higher the confidence in government and the greater the willingness of people and companies will be to pay taxes. When people get a fair return in public services and social benefits, they will be willing to pay the price for that. If, on the contrary, they have the impression that their money is not properly spent, they will be reluctant to contribute.

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(16) Fuest, C., Peichl, A. and Schaefer, T. (2007), Is a Flat Tax Politically Feasible in a Grown-Up Welfare State? quoted by Carone, Schmidt and Nicodème, op.cit. p. 18.

(17) Communication by the EC to the Council (2001), Towards an Internal Market without tax obstacles, COM (2001) 582 final.

From a social point of view, direct taxes should be privileged over indirect taxes. Taxation of capital income should be brought closer in line with taxation of labour income. Higher effective capital taxes on big companies and on personal capital income could help to reduce the tax on labour.

As far as companies are concerned, this can be done by setting normal corporate tax rates on a broad tax base, by simplifying the rules and procedures, by taxing capital gains realised on the sale of companies, by keeping an eye on cross border income flows (OECD transfer pricing guidelines), especially to tax havens, by regular control of companies' accounts by tax authorities and independant auditors, by concluding bilateral tax agreements with other countries, by imposing proportional penalties in case of tax fraud and finally by avoiding too generous special tax regimes.
SME's should be awarded a reduced tax rate.

As far as personal capital income is concerned, recurrent and socially corrected taxes can be levied on the income of immovable (houses, apartments, land) and movable (interests and dividends from bonds/shares) property. Transaction taxes and capital gain taxes on immovable property can also be implemented. Heritage taxes, where they exist, should be progressive within reasonable limits and non-discriminatory.

As to the taxation of labour income, a flat rate tax is not fair because it violates the basic principle that "the broadest shoulder should bear the heaviest burden". Labour income should be taxed according to a progressive scale, with a basic tax-free allowance. Tax allowances should also be foreseen for professional expenditure; limited tax credits can be awarded for social or environmental objectives (e.g. mortgages, work bonuses for older workers which work until they reach the legal retirement age, energy-saving investments, etc.). For non-active partners, splitting and separate taxation of labour income (and of extra-legal pension capital) can be important. For dependent children most governments offer a tax relief, besides the children allowance. Instead of this relief, an increased social transfer could be envisaged which would make the financial support for children more visible. The same principle could be applied for eco-investments.

Tax equity should be guaranteed between all professional groups. Abuses of the status of self-employed and of company statutes should be prevented. Double taxation of frontier workers should be avoided. And in order to protect the workers' standard of living, regular indexation or adjustment of the tax scales is necessary.

As to indirect taxation, and in particular consumption taxes, they should be conceived as a regulatory instrument to influence production and consumption, to promote a qualitative and sustainable economic growth and a healthy environment and way of life. Environmental taxes on energy, transport and pollution can be introduced or developed in order to reduce the tax on labour. Sweden applied this transfer with success. For reasons of social justice, a certain progressivity should be applied in VAT taxes : essential products and services should be taxed at a lower rate, whilst luxury products should be taxed at a higher rate or be subject to a special luxury tax. In order to protect the living standards of the weakest groups in society, care must be taken to ensure that indirect taxes do not become too predominant in the national tax systems.

As to social security contributions, they should be high enough to guarantee the adequacy and the sustainability of the statutory social benefits, taking into account the ageing of societies. The higher social benefits can be taxed at a reduced rate. The lowest benefits should be tax-free.

In order to increase the effectiveness of the tax system, tax evasion and tax fraud has to be tackled. Different measures can contribute to improve tax collection and to increase compliance :

- improve the tax administration capacity;
- invest in the recruitment, training and modern equipment of the tax and social inspectors (IPA has funds available for capacity building);
- regular control of company accounts and of banks (in the EU banks will be obliged as from 2015 to report per country their benefits and paid taxes);
- all salaries and bonusses have to be paid via bank accounts (e.g. in the Belgian metal sector, for electricians : no end of the year bonus payment without bank account);
- all commercial transactions above 1000 euro obligatory via bank accounts (cf. Italy);
- promotion of declared work via tax incentives (e.g. deductability of certain goods and services) and better information of workers on the long term benefits of declared work (decent pension);
- data-mining, data-matching and data-sharing : organise the linking of different data-bases, e.g. between declared income and data on spendings via creditcard (cf. Italy), between the employment register and the social security funds, between declared income and the registration of cars or appartments, etc.
- obligation to register recruted workers before they start working;
- establishment of a central register of all bank accounts and control of bank accounts in case of indications of tax fraud;
- tight control on transactions in certain sensitive economic niches : antiques, art, gold, jewellery;
- introduction of electronic cash registers for horeca;
- include in the annual tax declaration form a question asking if the person has a banc account or insurance abroad;
- regularisation and amnesty possibilities for the repatriation of capital, with reasonable financial penalties;
- mutual automatic information exchange agreements with foreign tax authorities on income of non-residents.

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