



# Role of tax policy in times of fiscal consolidation:

Lessons from the 2012 report  
'Tax reforms in EU Member States'

DG ECFIN Workshop

Brussels – Berlaymont Building, Walter Hallstein Room  
Thursday, 18 October 2012

# Outline

I. Introduction

II. Recent tax reforms

III. Main tax challenges

IV. Redistributive considerations

# I. Introduction

- Report jointly produced by ECFIN and TAXUD.
  - **European Semester** (the cycle of integrated economic coordination) underline the importance of the design and structure of the tax system to make them more effective, efficient and fairer, while acknowledging MS may need to increase taxes (AGS, 2012).
  - **Euro Plus Pact** (March 2011) calls for labour tax reforms and structured discussion on tax issues.
- **The TRR contributes to this discussion and serves as an analytical input to the 2013 European Semester.**

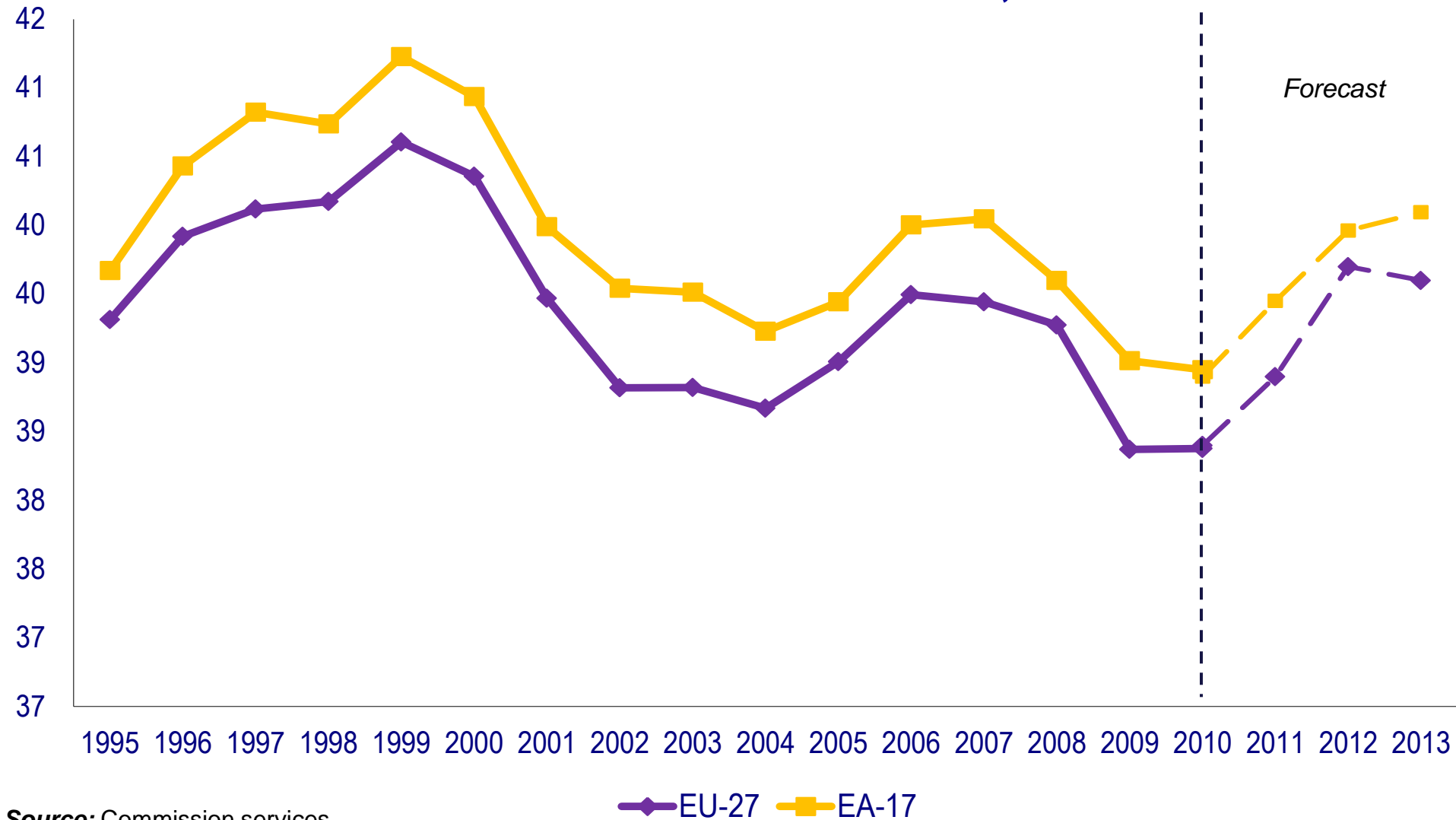
## II. Recent tax reforms

- Given public finances deterioration and turbulence in sovereign debt markets, fiscal policies in 2011-2012 were driven by the need to restore their sustainability
- For most MSs, the need for more revenue to support consolidation effort was compounded by other difficulties:
  - *stemming from the need to support recovery*
  - *restore sustained growth over the medium/long term.*
- Tax revenue in the EU increased in 2011 and this upward trend is expected to continue until 2013 at least...
- ... despite adverse cyclical conditions and automatic revenue loss

# II. Recent tax reforms

## Development of the overall tax burden

### Tax-to-GDP ratio in EU-27 and euro area, 1995-2013



Source: Commission services.

# II. Recent tax reforms

## General trends over 2011-2012

- In the period 2011-2012, many MS have increased PIT, mainly through hikes in statutory rates, or social security contribution, while aiming at increasing work incentives for specific groups.
- Changes in the corporate tax bases have been slightly more frequent.
- About half of the MS saw hikes in the VAT rates, both in the standard rate and the reduced ones.
- Excise duties increased in most MS for environment and energy products and for alcohol and tobacco.

# II. Recent tax reforms

## Overview of tax reforms in 2011 and 2012

		Statutory rates	Base or special regimes
<b>Personal Income Tax</b>	Increase	BE, DK, CY, FI, EL, ES, IE, IT, LU*, NL, PT	AT, BE, CZ*, DK, ES**, FI, FR, EL, HU, IE, PL, PT, SK, UK
	Decrease	FI, HU, LV, NL	CZ, DK, EE, FI, DE, ES, HU, IE, LV, MT, NL, SE, UK
<b>Corporate Income Tax</b>	Increase	FR, PT	CZ, AT, BE, DK, ES**, HU
	Decrease	UK, FI, EL, SI, NL,	ES, HU, IT, LT, LU, UK
<b>Social Security Contributions</b>	Increase	AT, BG, CY, FR, EL, HU, LV, PL, PT, UK	IE, SK
	Decrease	DE, IE	CZ
<b>Value Added Tax</b>	Increase	PT, UK, CY, ES**, IE, HU, LV, PL, SK, IT, FR, BG, EL, CZ	AT, BE, BG, CY, DK, EL, ES**, FI, LV, NL, PL, PT,
	Decrease		CY, EL, ES, IE, LT, PL
<b>Excise Duties</b>	Increase	AT, BE, BG, CY, CZ, DE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, PL, PT, RO, SE, SK, SI, UK	DK, EE, LV, PL
	Decrease	SI	
<b>Taxation of Property</b>	Increase	CY, EL, ES, IE, PT, UK	CY, IT, LT, LV
	Decrease	NL	

**Source:** Commission services.

# III. Main tax challenges

## Issues for tax policy in consolidation times (I)

- **Consolidation effort requires extra tax revenue in some MSs**
  - *Identifying both need and ...*
  - *.... scope for further tax hikes in the short term*
  - *Cutting expenditures in medium run to reduce gradually the weight of taxes in some countries*
  - *Broadening the tax bases (closing loopholes in direct and indirect taxation) rather than increasing tax rates*



# III. Main tax challenges

## Issues for tax policy in consolidation times (II)

- **Consolidation need is also an occasion to rationalise the tax systems by revenue-neutral efficiency-friendly reforms**
  - *Broadening the tax bases*
  - *Tax shifts toward growth-enhancing tax bases (away from labour toward consumption, property and environment)*
  - *Improving governance and quality of tax administration*
- **Social equity: bearing the burden of tax increase (and consolidation) fairly across the society**
  - *Redistribution/efficiency frontier*
  - *Collective preferences*

# III. Main tax challenges

## Overview table

Country	Contribution of tax increases to consolidation	Need and room for tax shift	Broadening tax bases				Tax governance challenges		Special topics			
			Need to review tax expenditure in PIT	Need to review tax expenditure in CIT	Debt bias in corporate taxation	Increasing VAT efficiency	Tax compliance	Tax administration	Housing taxation		Environmental taxation	
									Structural shift	Debt bias	GHG target	Design
BE		X	(X)	X		(X)	X		X	X	X	X
DE		(X)			(X)							X
EE										X		
IE	-			X		(X)					X	
EL	-		X		X	X	X	X	X	X	X	X
ES	X		X	X	(X)	X	X		X	X		
FR		X	X	X	X	(X)			X			X
IT		X	X			X	X		X	X	(X)	X
CY							(X)		X		(X)	
LU				X	X				X	X	X	X
MT	X			X	X		X				X	
NL				X						X		
AT		(X)	X								(X)	
PT	-		X	X	X	(X)	X	X	X	X		X
SI	X			X			X				(X)	
SK	X					(X)	X	X			X	X
FI										X	(X)	
BG							X	X				
CZ		X		X		(X)	X	X		X		
DK										X	(X)	
LV		X		X		X						
LT				X		(X)	X				X	X
HU		(X)				(X)	X					
PL			(X)			(X)	X	X				
RO		X		X		X	X	X				
SE					(X)					X		
UK			X	X		X						

**Source:** Commission services.

# III. Main tax challenges

## Zoom (I)

Country	Contribution of tax increases to consolidation	Need and room for tax shift	Broadening tax bases			
			Need to review tax expenditure in PIT	Need to review tax expenditure in CIT	Debt bias in corporate taxation	Increasing VAT efficiency
BE		X	(X)	X		(X)
DE		(X)			(X)	
EE						
IE	-			X		(X)
EL	-		X		X	X
ES	X		X	X	(X)	X
FR		X	X	X	X	(X)
IT		X	X			X
CY						
LU				X	X	
MT	X			X	X	
NL				X		
AT		(X)	X			
PT	-		X	X	X	(X)
SI	X			X		

# III. Main tax challenges

## Zoom (II)

Tax governance challenges				Special topics				
Tax compliance		Tax administration		Housing taxation		Environmental taxation		
				Structural shift	Debt bias	GHG target	Design	
X				X	X	X	X	X
								X
					X			
						X		
X		X		X	X	X	X	X
X				X	X			
				X				X
X				X	X	(X)		X
(X)				X		(X)		
				X	X	X	X	X
X						X		
					X			

# III. Main tax challenges

- Several EU MS could consider increasing revenue to consolidate their public finances.
- Around a third of MS appear to have both room and need for a tax shift away from labour toward consumption taxes, recurrent property taxes, environmental taxes.

# III. Main tax challenges

## Screening principles to identify a potential relevance for tax-based consolidation

- *The need: Fiscal sustainability problems*

Fiscal sustainability if considered problematic, if:

i) the indicator of fiscal sustainability gap in the medium term, "S1" is high

OR

ii) the indicator of fiscal sustainability gap in the long term, "S2" is high

- *The scope: Availability of tax space*

AND: 2) There is 'overall tax space' currently available

AND EITHER: 2a) There is still scope for increasing the least distortionary taxes

OR: 2b) The tax burden has not increased substantially in the recent past.

# III. Main tax challenges

## Overview on fiscal consolidation on revenue

Country	Potential need for higher tax revenues to help consolidation	Overall 'tax space' available (low tax-to-GDP ratio)	No significant increase in tax-to-GDP ratio in recent years	Scope for (further) increasing least distortionary taxes
BE	X		X	X
DE			X	X
EE		X	X	(X)
ES	X	X	X	X
FR			X	X
IT				X
CY		X	X	(X)
LU	X		X	X
MT	X	X	X	X
NL	X		X	
AT			X	X
SI	X	X	X	(X)
SK	X	X	X	X
FI			X	
BG		X	X	(X)
CZ		X		X
DK			X	
LV		X	X	X
LT		X	X	X
HU			X	(X)
PL		X	X	
RO		X	X	X
SE			X	
UK	X		X	(X)

**Source:** Commission services.

# III. Main tax challenges

## Screening results on tax structure challenges

Country	High tax burden on labour		Potential to shift			Need and room for tax shift
	Overall	Specific groups	Low consumption taxes	Low recurrent taxes on housing	Low tax burden on the environment	
BE	X	X	(X)		X	X
DE	(X)	(X)	(X)	X		(X)
EE				X		
IE			X			
EL			X	X	X	
ES			X		X	
FR	X	X	X		X	X
IT	X	X	X			X
CY			(X)			
LU			X			
MT			(X)	X		
NL		(X)				
AT	(X)	(X)		X	X	(X)
PT			X			
SI				X		
SK			X	X	X	
FI	(X)					
BG				X		
CZ	X		(X)	X	X	X
DK						
LV		X	(X)		X	X
LT			X	X	X	
HU	X	X		X		(X)
PL						
RO		X	(X)		X	X
SE	(X)	(X)				
UK			(X)			

**Source:** Commission services.



# IV. Redistributive considerations

Beyond efficiency of national tax systems, the redistributive effects of the tax system can be equally important.

Some channels:

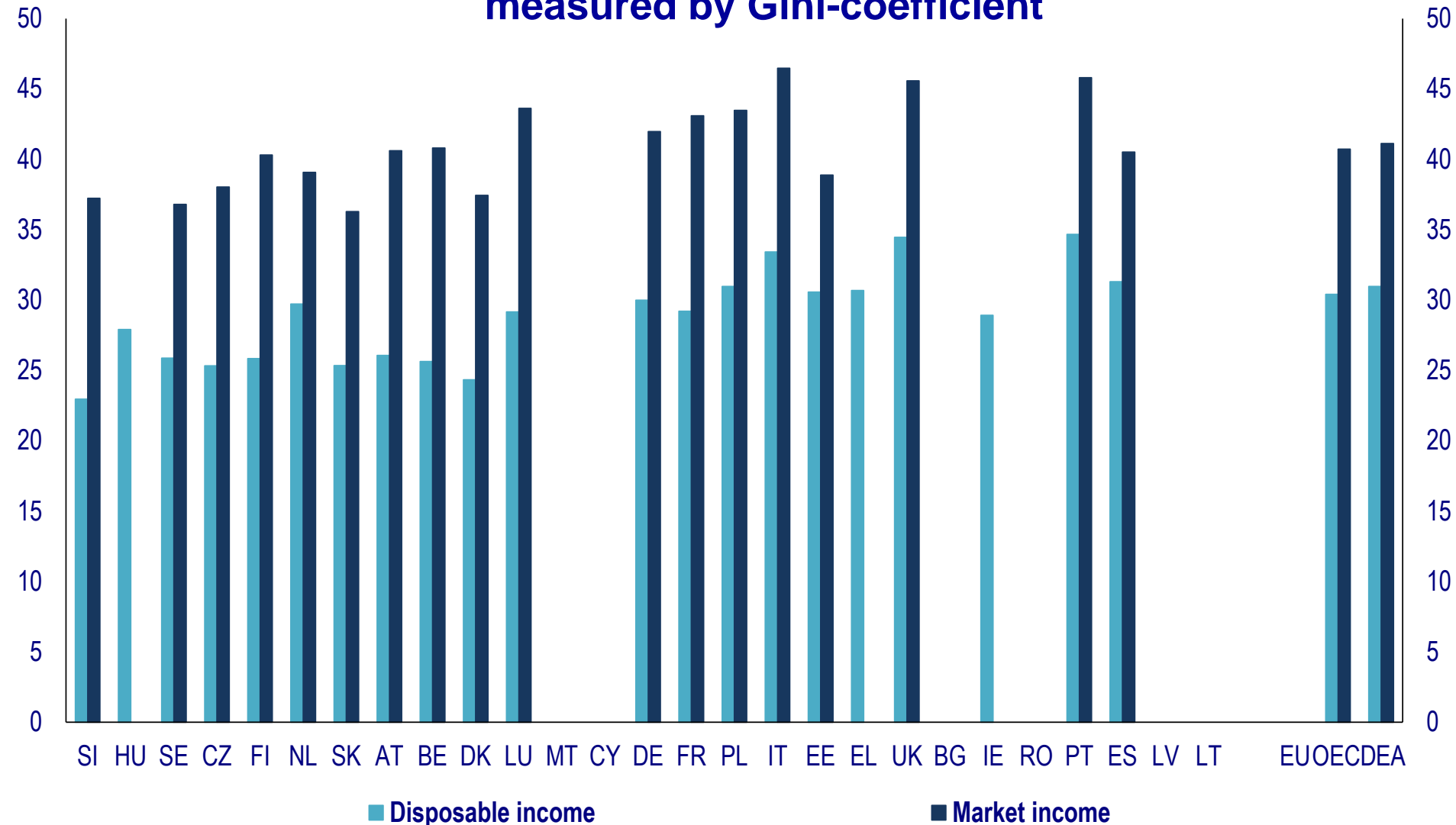
- i) progressive tax scale for labour income*
- ii) tax expenditure making the system often regressive*
- iii) labour disincentives to work embedded in tax system hitting the low skilled*

# IV. Redistributive considerations

- However, a MS facing substantial efficiency challenges in the tax-benefit system (e.g. large share of tax expenditures)...
- ... and at the same time achieving a poor outcome in terms of mitigating income inequalities may have scope for...
- improving efficiency without compromising redistribution policies
- or increasing redistribution without harming efficiency.
- Need to take the sustainability of public finances into account.

# IV. Redistributive considerations

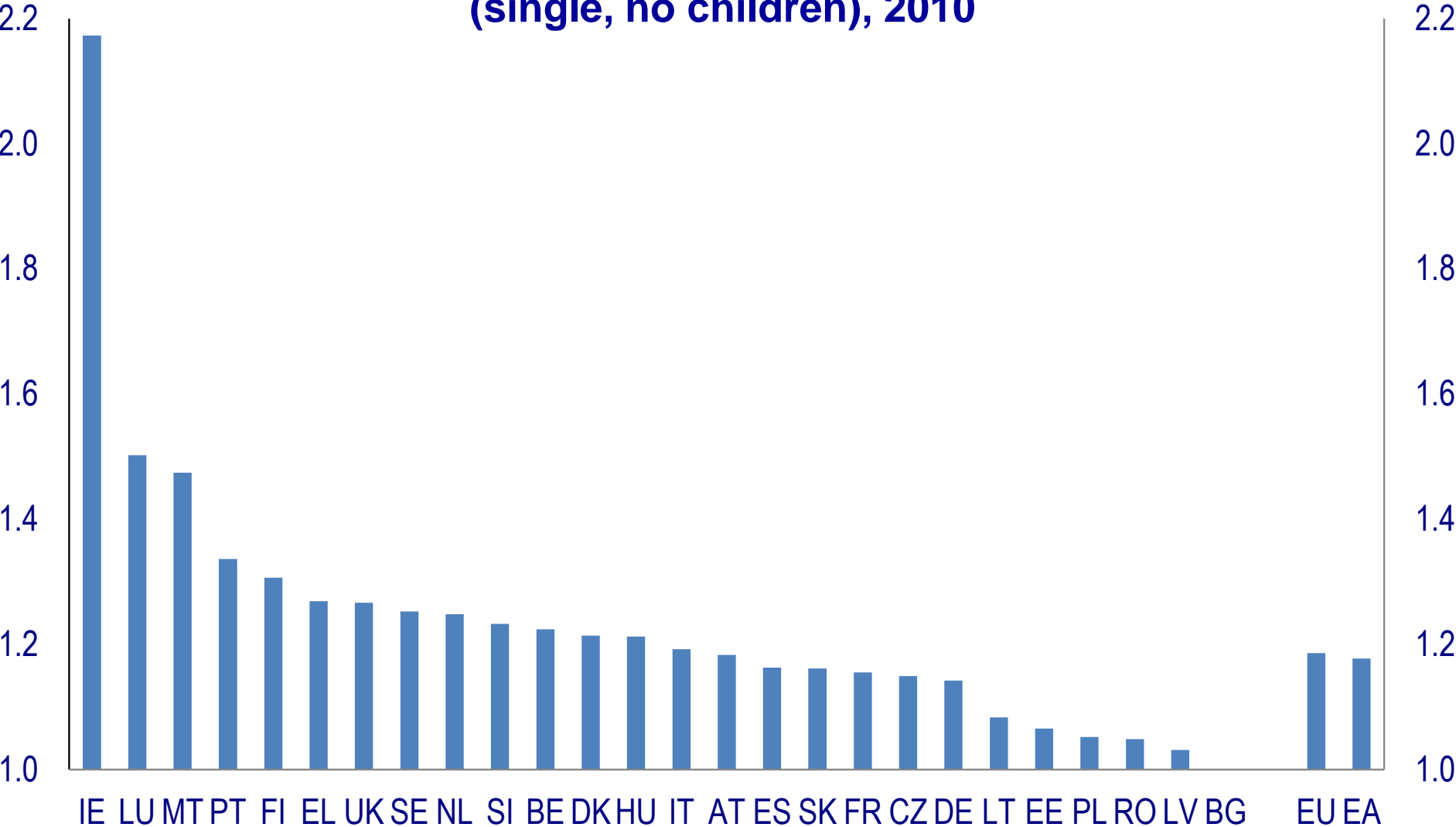
## Concentration of market income and disposable income measured by Gini-coefficient



Source: OECD and Commission services.

# IV. Redistributive considerations

Ratio of tax wedge 167% / 67% of the average worker (single, no children), 2010



Source: Commission services and OECD.

**THANK YOU**

# DG ECFIN publications

European Commission (2012), Tax reforms in EU Member States 2012: tax policy challenges for economic growth and fiscal sustainability, European Economy 6/2012.

Gayer, C. and G. Mourre (2012), Property taxation and enhanced tax administration in challenging times. Proceedings of ECFIN workshop on 24 November 2011, European Economy, Economic Paper 463, European Commission.

Jensen, J. and F. Wöhlbier (2012), Improving tax governance in EU Member States: criteria for successful policies, European Economy, Occasional Paper 114, European Commission.

Johannesson-Linden, A. and C. Gayer (2012), Possible reforms of real estate taxation: criteria for successful policies, European Economy, Occasional Papers, forthcoming.

Wöhlbier, F., Gayer, C., Isbasoiu, G. and G. Mourre (2012), Fiscal consolidation and growth-friendly tax structures, mimeo.

# Annex (I)

## Draft Report Outline

**Ch 1. Introduction.**

**Ch 2. Level, structure and trends of tax revenues in the EU.**  
Descriptive and indicator-based.

**Ch 3. Recent reforms of tax systems in the EU.** Overview of tax reforms recently implemented in MS (2011/2012) and common trends across countries.

**Ch 4. The review of the VAT system in the EU and its policy implications.** New thematic chapters, heavily based on IFS studied commissioned by TAXUD.

**Ch 5. Tax policy challenges in EU Member States.**

# Annex (II)

## *Broadening the base*

- Many Member States need to review/reduce tax expenditure in direct taxation, especially in corporate income taxation.
- The debt bias in corporate taxation represents a challenge in almost a third of MSs.
- Many MS still face a high policy gap in the area of VAT (despite recent measures).



# Annex (III)

## *Improving tax governance*

A number of Member States face the challenge of improving tax governance:

- *a large shadow economy*
- *high levels of potential VAT fraud and evasion*
- *a particular potential to increase the efficiency of the tax administration.*

Better tax administration identified as a challenge in a third of MS:

- *high administrative costs per net revenue collected*
- *non-utilisation of third party information to prefill tax returns*
- *low extent of e-filing*
- *the high administrative burden of tax systems for mid-sized companies.*

# Annex (IV)

## *Housing taxation*

- Housing taxation is often based too much on distortive transaction taxes, thus some MS could consider a shift within property taxation in favour of the recurrent tax.
- Nearly half of the MS face the challenge to reduce the debt bias in housing taxation created by deductibility of mortgage interests.
- In these countries, either imputed rents or recurrent property taxes on owner-occupied housing are too low compared to the taxes on other capital investments.
- Given the political difficulty to raise property taxes, a second-best option could be to gradually phase out the interest rate deductibility in order to remove this debt bias and levy a lower recurrent tax on housing.

# Annex (V)

## *Environmental policies*

Ensure that the policy instruments in place, including taxes, are sufficient to meet the agreed environmental objectives, e.g. the greenhouse gas emission target.

Energy taxes and other environmental taxes to be designed to provide appropriate incentives to reduce emissions over time.

- i) adjusting the structure of tax rates on fossil fuels according to their carbon and energy content*
- ii) indexing environmental taxes*
- iii) reconsidering reduced VAT rates on energy*
- iv) reducing tax subsidies for company cars*
- v) introducing CO<sub>2</sub>-related vehicle taxation.*