



Political economy of tax reforms

Main lessons from the 2015 "Tax Reforms Report"

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Brussels, 19 October 2015

Context

- Tax reform can contribute to the stability of public finances, boost economic growth and employment, and improve social fairness. However: reform efforts are often limited given the size of the challenge.
- 2015 edition of the annual Tax Reforms Report prepared jointly by DGs ECFIN and TAXUD.
- The report contributes to the discussion on tax reforms and serves as an analytical input to the 2016 European Semester (the process that culminates in country-specific recommendations to the Member States).

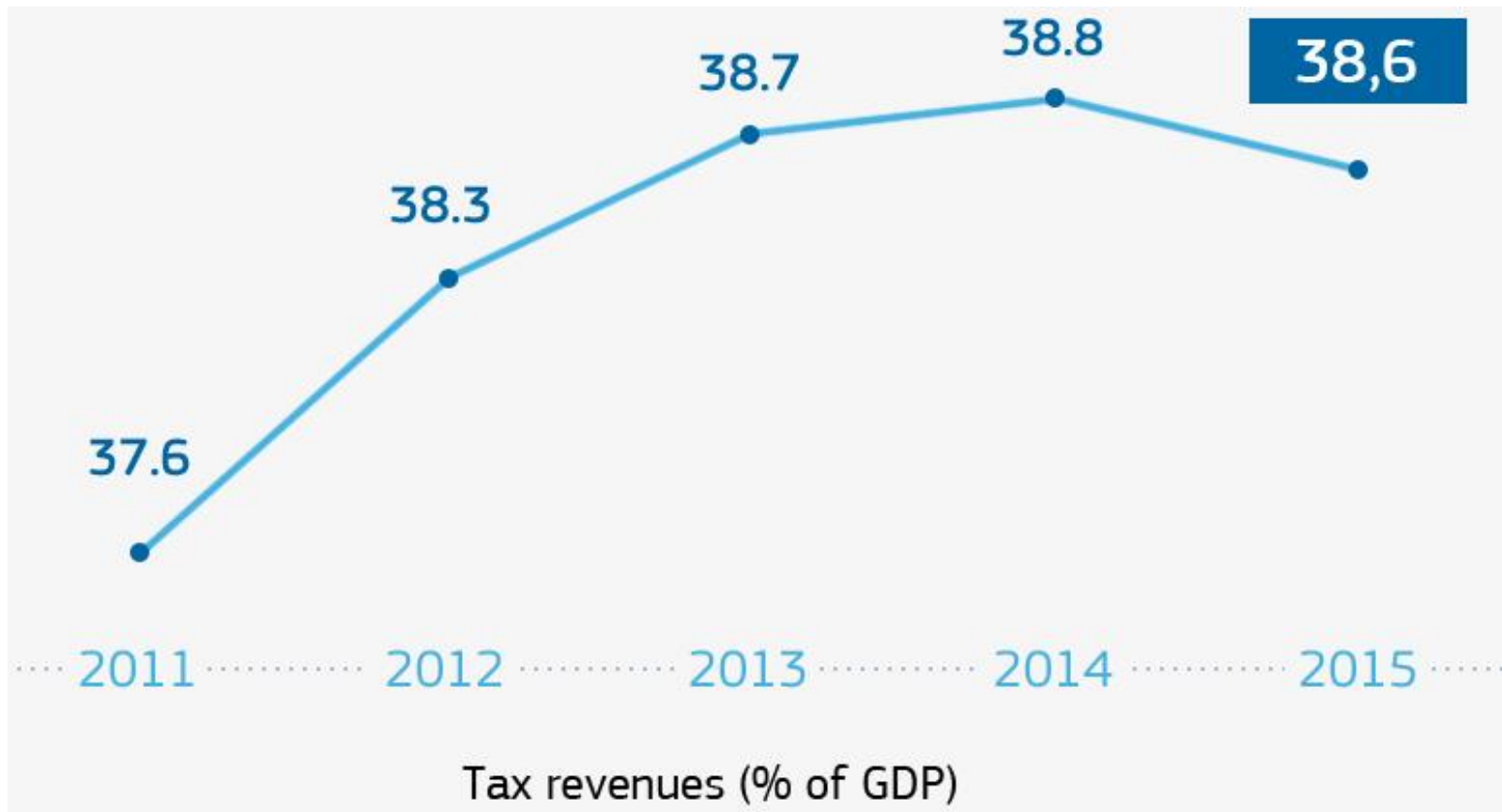
Main elements of the report

The Tax Reforms Report presents:

- An overview of recent tax reforms in EU Member States
- An indicator-based framework to:
 - ... identify potential policy challenges in key areas of tax policy in EU Member States...
 - ... with a view to improving the contribution of tax policy to macroeconomic performance

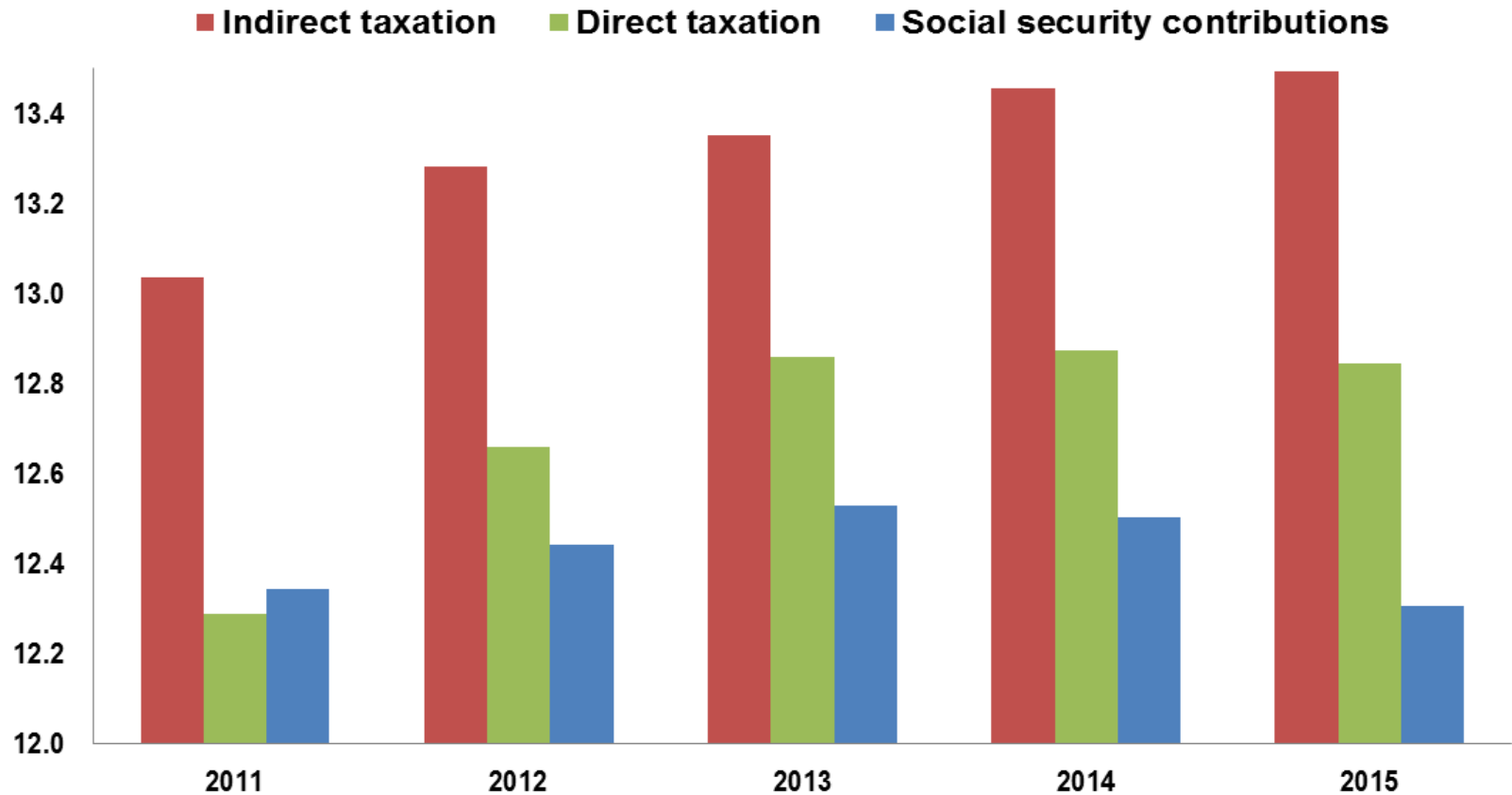
Level of taxation

Over the last years, Member States have increased the overall tax burden. However, in 2015, it is expected to slightly decrease...



Level of taxation

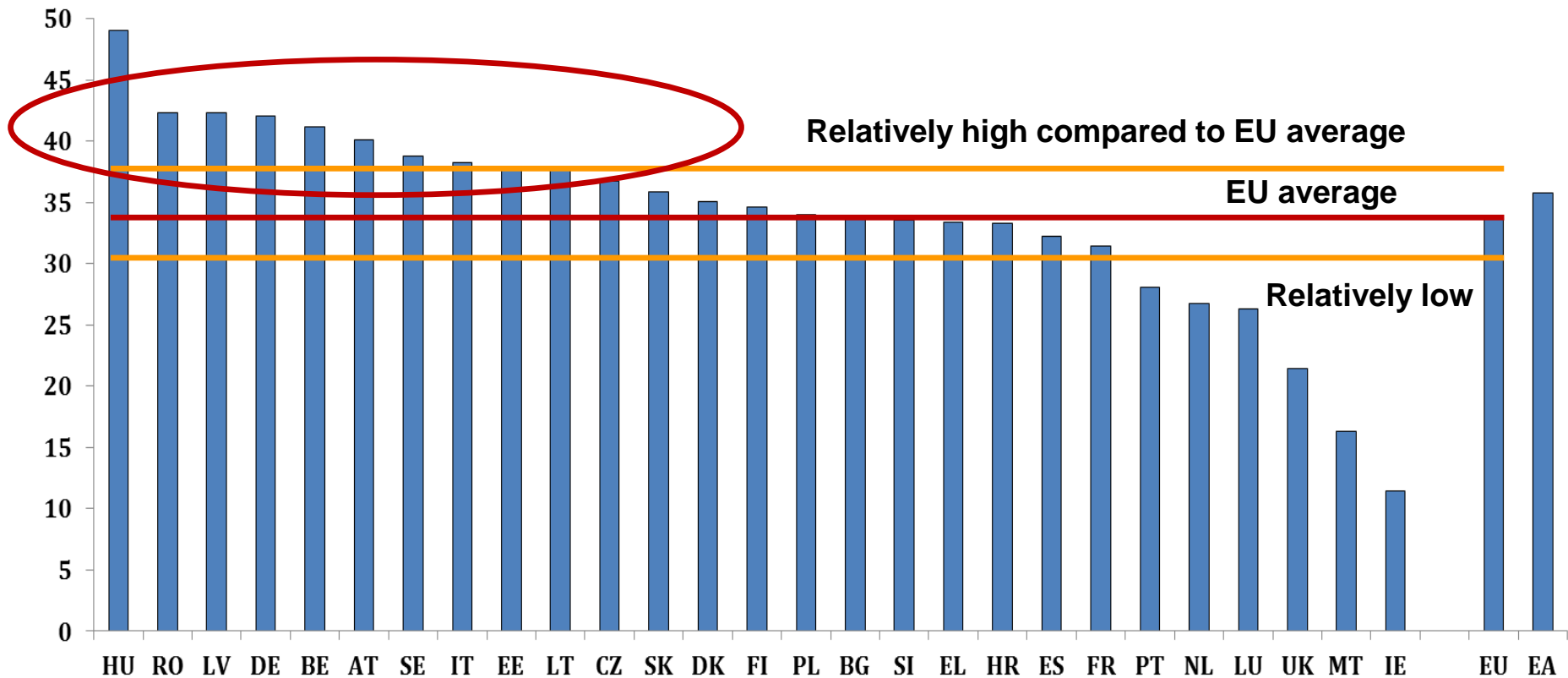
... in particular because social security contributions are expected to decrease



Identification of challenges: general approach

- Indicator-based approach.
- Identifying relatively good and poor performers by comparing to the EU average ("benchmarking").
- Benchmarking has recently received a lot of attention: Five-Presidents Report, Eurogroup agreement to benchmark labour taxation.
- Need for additional country-specific analysis before drawing firm conclusions. This analysis is carried out in the European Semester.

Benchmarking example: tax burden on labour for low income earners



Tax policy challenges in EU Member States

The report covers a number of key policy areas:

- Taxation and the sustainability of public finances
- Labour taxation
- Housing taxation
- Debt bias in corporate taxation
- VAT design and compliance
- Environmentally-related taxes
- Tax administration and tax compliance
- Taxation and redistribution

Main findings: labour taxation

- Many EU Member States have relatively high labour taxes (overall or for specific groups), which impacts negatively on economic activity and employment.
- Several Member States carried out reforms but often relatively limited compared to the size of the challenge.
- The main challenge is finding the funds to finance a labour tax cut. Given strained public finances, unfinanced cuts are generally not an option. Some Member States have relatively low "growth-friendly" taxes but it may be difficult to raise these. There may, for example, be distributional effects of a shift in the tax burden from labour to consumption taxes.

Main findings: VAT

- VAT is a relatively growth-friendly tax. Some Member States make particularly much use of reduced rates and non-compulsory exemptions. Leads to loss of revenue and economic distortions.
- A number of Member States limited the use of reduced rates or raised these rates. Others however took steps in the other direction.
- It is difficult to address reduced rates due to vested interests. At the same time introducing new reduced rates is a relatively simple (if not necessarily the most effective) tool to provide support to certain groups.

Main findings: housing taxation

- Some Member States have high property transaction taxes (which inter alia hamper labour mobility) while, at the same time, their recurrent property taxes are not high. This situation argues for a shift within housing taxation.
- Some Member States have generous mortgage interest deductibility, creating an incentive to take up debt.
- Reform in this area is relatively limited. Housing taxation is quite visible. Also, different levels of government may be affected. Difficult to address mortgage interest deductibility as important, long-term decisions have been based on its existence.

Main findings: tax evasion and avoidance

- Tax evasion and tax avoidance are important challenges.
- Many Member States are undertaking action in this area.
- Addressing these challenges requires action at the national level but supplementary action at EU level and the international level is necessary to address for example aggressive tax planning by multinational companies.

Main findings: redistribution

- While inequality measured by market income rose significantly during the crisis years, on average income inequality after taxes and benefits changed relatively little.
- However, there is significant variation between Member States and low-income households in some Member States have seen their living standards deteriorate disproportionately.
- Fairness is an important aspect in the design of tax reforms.

Tax reforms report

The full report may be found at:

http://ec.europa.eu/economy_finance/publications/eeip/ip008_en.htm

http://ec.europa.eu/taxation_customs/common/publications/services_papers/working_papers/index_en.htm